Legislative Proposals and Explanatory Notes Relating to Income Tax

Published by
The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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Canada

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Legislative Proposals

PART 1

INCOME TAX ACT

1. (1) The portion of subsection 7(1) of the *Income Tax Act* before paragraph (*a*) is replaced by the following:

Agreement to issue securities to employees

7. (1) Subject to subsections (1.1) and (8), where a particular qualifying person has agreed to sell or issue securities of the particular qualifying person (or of a qualifying person with which it does not deal at arm's length) to an employee of the particular qualifying person (or of a qualifying person with which the particular qualifying person does not deal at arm's length),

(2) Subsection 7(1.3) of the Act is replaced by the following:

Order of disposition of securities

(1.3) For the purposes of this subsection, subsections (1.1) and (8), subdivision c, subparagraph 110(1)(*d*.1)(ii) and subsection 147(10.4), and subject to subsection (1.31) and paragraph (14)(*c*), a taxpayer is deemed to dispose of securities that are identical properties in the order in which the taxpayer acquired them and, for this purpose,

(*a*) where a taxpayer acquires a particular security (other than under circumstances to which subsection (1.1) or (8) or 147(10.1) applies) at a time when the taxpayer also acquires or holds one or more other securities that are identical to the particular security and are, or were, acquired under circumstances to which any or subsections (1.1) or (8) or 147(10.1) applied, the taxpayer is deemed to have acquired the particular security at the time immediately preceding the earliest of the times at which the taxpayer acquired those other securities; and

(*b*) where a taxpayer acquires, at the same time, two or more identical securities under circumstances to which either subsection (1.1) or (8) applied, the taxpayer is deemed to have acquired the securities in the order in which the agreements under which the taxpayer acquired the rights to acquire the securities were made.

Disposition of newly-acquired security

(1.31) Where a taxpayer acquires, at a particular time, a particular security under an agreement referred to in subsection (1) and, on a day that is no later than 30 days after the day that includes the particular time, the taxpayer disposes of a security that is identical to the particular security, the particular security is deemed to be the security that is so disposed of if

(*a*) no other securities that are identical to the particular security are acquired, or disposed of, by the taxpayer after the particular time and before the disposition;

(*b*) the taxpayer identifies the particular security as the security so disposed of in the taxpayer's return of income under this Part for the year in which the disposition occurs; and

(*c*) the taxpayer has not so identified the particular security, in accordance with this subsection, in connection with the disposition of any other security.

(3) Paragraph 7(1.4)(*d*) of the Act is replaced by the following:

(*d*) the taxpayer is deemed <u>(other than for the purpose of subparagraph (9)(*d*)(ii))</u> not to have disposed of the exchanged option and not to have acquired the new option,

(4) Subsection 7(1.5) of the Act is replaced by the following:

Rules where securities exchanged

(1.5) For the purposes of this section and <u>paragraphs 110(1)(*d*) to (*d*.1)</u>, where

(*a*) a taxpayer disposes of or exchanges <u>securities of a particular qualifying person</u> that were acquired by the taxpayer under <u>circumstances to which either subsection (1.1) or (8) applied</u> (in this subsection referred to as the "exchanged <u>securities</u>"),

(*b*) the taxpayer receives no consideration for the disposition or exchange of the exchanged <u>securities</u> other than <u>securities</u> (in this subsection referred to as the "new <u>securities</u>") of

(i) the <u>particular qualifying person</u>,

(ii) a qualifying person with which the particular qualifying person does not deal at arm's length immediately after the disposition or exchange,

(iii) a corporation formed on the amalgamation or merger of the particular qualifying person and one or more other corporations,

(iv) a mutual fund trust to which the particular qualifying person has transferred property in circumstances to which subsection 132.2(1) applied, or

(v) a qualifying person with which the corporation referred to in subparagraph (iii) does not deal at arm's length immediately after the disposition or exchange, and

(*c*) the total value of the new securities immediately after the disposition or exchange does not exceed the total value of the old securities immediately before the disposition or exchange,

the following rules apply:

(*d*) the taxpayer is deemed not to have disposed of or exchanged the exchanged securities and not to have acquired the new securities,

(*e*) the new securities are deemed to be the same securities as, and a continuation of, the exchanged securities, except for the purpose of determining if the new securities are identical to any other securities,

(*f*) the qualifying person that issued the new securities is deemed to be the same person as, and a continuation of, the qualifying person that issued the exchanged securities, and

(*g*) where the exchanged securities were issued under an agreement, the new securities are deemed to have been issued under that agreement.

(5) The portion of subsection 7(2) of the Act before paragraph (*a*) is replaced by the following:

Securities held by trustee

(2) If a security is held by a trustee in trust or otherwise, whether absolutely, conditionally or contingently, for an employee, the employee is deemed, for the purposes of this section and paragraphs 110(1)(*d*) to (*d*.1),

(6) The portion of paragraph 7(6)(*a*) of the Act before subparagraph (i) is replaced by the following:

(*a*) for the purposes of this section (other than subsection (2)) and paragraphs 110(1)(*d*) <u>to</u> (*d*.1),

(7) The portion of subsection 7(7) of the Act before the definition "qualifying person" is replaced by the following:

Definitions

(7) The definitions in this subsection apply in this section and in <u>subsection 47(3), paragraphs 53(1)(*j*) and</u> 110(1)(*d*) <u>and (*d*.01) and subsections 110(1.5), (1.6) and (2.1)</u>.

(8) Section 7 of the Act is amended by adding the following after subsection (7):

Deferral in respect of non-CCPC employee options

(8) Where a particular qualifying person (other than a Canadian-controlled private corporation) has agreed to sell or issue securities of the particular qualifying person (or of a qualifying person with which it does not deal at arm's length) to a taxpayer who is an employee of the particular qualifying person (or of a qualifying person with which the particular qualifying person does not deal at arm's length), in applying paragraph (1)(*a*) in respect of the taxpayer's acquisition of a security under the agreement, the reference in that paragraph to "the taxation year in which the employee acquired the securities" shall be read as a reference to "the taxation year in which the employee disposed of or exchanged the securities" if

(*a*) the acquisition is a qualifying acquisition; and

(*b*) the taxpayer elects, in accordance with subsection (10), to have this subsection apply in respect of the acquisition.

Meaning of "qualifying acquisition"

(9) For the purpose of subsection (8), a taxpayer's acquisition of a security under an agreement made by a particular qualifying person is a qualifying acquisition if

(*a*) the acquisition occurs after February 27, 2000;

(*b*) the taxpayer would, if this Act were read without reference to subsection (8), be entitled to deduct an amount under paragraph 110(1)(*d*) in respect of the acquisition in computing income for the taxation year in which the security is acquired;

(*c*) if the particular qualifying person is a corporation, the taxpayer was not, at the time immediately after the agreement was made, a specified shareholder of any of the following:

(i) the particular qualifying person,

(ii) any qualifying person that, at that time, was an employer of the taxpayer and was not dealing at arm's length with the particular qualifying person, and

(iii) the qualifying person of which the taxpayer had, under the agreement, a right to acquire a security; and

(*d*) if the security is a share,

(i) it is of a class of shares that, at the time the acquisition occurs, is listed on a prescribed stock exchange, and

(ii) where rights under the agreement were acquired by the taxpayer as a result of one or more dispositions to which subsection (1.4) applied, none of the rights that were the subject of any of the dispositions included a right to acquire a share of a class of shares that, at the time the rights were disposed of, was not listed on any prescribed stock exchange.

Election for purposes of subsection (8)

(10) For the purpose of subsection (8), a taxpayer's election to have that subsection apply in respect of the taxpayer's acquisition of a particular security under an agreement referred to in subsection (1) is in accordance with this subsection if

(*a*) the election is filed, in prescribed form and manner at a particular time that is before January 16 of the year following the year in which the acquisition occurs, with a person who would be required to file an information return in respect of the acquisition if subsection (8) were read without reference to paragraph (8)(*b*);

(*b*) the taxpayer is resident in Canada at the time the acquisition occurs; and

(*c*) the specified value of the particular security does not exceed the amount by which

(i) $100,000

exceeds

(ii) the total of all amounts each of which is the specified value of another security acquired by the taxpayer at or before the particular time under an agreement referred to in subsection (1), where

(A) the taxpayer's right to acquire that other security first became exercisable in the year that the taxpayer's right to acquire the particular security first became exercisable, and

(B) at or before the particular time, the taxpayer has elected in accordance with this subsection to have subsection (8) apply in respect of the acquisition of that other security.

Meaning of "specified value"

(11) For the purpose of paragraph (10)(*c*), the specified value of a particular security acquired by a taxpayer under an agreement referred to in subsection (1) is the amount determined by the formula

$$A/B$$

where

Ais the fair market value, determined at the time the agreement was made, of a security which was the subject of the agreement at the time the agreement was made; and

Bis

(*a*) except where paragraph (*b*) applies, 1, and

(*b*) where the number or type of securities that are the subject of the agreement has been modified in any way after the time the agreement was made, the number of securities (including any fraction of a security) which it is reasonable to consider the taxpayer would, at the time the particular security was acquired, have a right to acquire under the agreement in lieu of one of the

securities that were the subject of the agreement at the time the agreement was made.

Identical options – order of exercise

(12) Unless the context otherwise requires, a taxpayer is deemed to exercise identical rights to acquire securities under agreements referred to in subsection (1)

(*a*) where the taxpayer has designated an order, in the order so designated; and

(*b*) in any other case, in the order in which those rights first became exercisable and, in the case of identical rights that first became exercisable at the same time, in the order in which the agreements under which those rights were acquired were made.

Revoked election

(13) For the purposes of this section (other than this subsection), an election filed by a taxpayer to have subsection (8) apply to the taxpayer's acquisition of a security is deemed never to have been filed if, before January 16 of the year following the year in which the acquisition occurs, the taxpayer files with the person with whom the election was filed a written revocation of the election.

Deferral deemed valid

(14) For the purposes of this section and paragraph 110(1)(*d*), where a taxpayer files an election to have subsection (8) apply in respect of the taxpayer's acquisition of a particular security and subsection (8) would not apply to the acquisition if this section were read without reference to this subsection, the following rules apply if the Minister so notifies the taxpayer in writing:

(*a*) the acquisition is deemed, for the purpose of subsection (8), to be a qualifying acquisition;

(*b*) the taxpayer is deemed to have elected, in accordance with subsection (10), to have subsection (8) apply in respect of the acquisition; and

(*c*) if, at the time the Minister sends the notice, the taxpayer has not disposed of the security, the taxpayer is deemed (other than for the purpose of subsection (1.5)) to have disposed of the security at that

time and to have acquired the security immediately after that time other than under an agreement referred to in subsection (1).

Withholding

(15) Where, because of subsection (8), a taxpayer is deemed by paragraph (1)(*a*) to have received a benefit from employment in a taxation year, the benefit is deemed to be nil for the purpose of subsection 153(1).

Prescribed form for deferral

(16) Where, at any time in a taxation year, a taxpayer holds a security that was acquired under circumstances to which subsection (8) applied, the taxpayer shall file with the Minister, with the taxpayer's return of income for the year, a prescribed form containing prescribed information relating to the taxpayer's acquisition and disposition of securities under agreements referred to in subsection (1).

(9) Subsections (1), (3), (5), (6) and (8) apply to the 2000 and subsequent taxation years except that,

(*a*) in applying paragraph 7(10)(*a*) of the Act, as enacted by subsection (8), to securities acquired in 2000, the reference in that paragraph to "January 16" shall be read as a reference to "February 16"; and

(*b*) a written request under subsection 7(13) of the Act, as enacted by subsection (8), to revoke an election in respect of a security acquired in 2000 is deemed to have been filed in a timely manner if it is filed on or before the day that is 60 days after the day on which this Act receives royal assent.

(10) Subsection (2) applies to securities acquired, but not disposed of, before February 28, 2000 and to securities acquired after February 27, 2000.

(11) Subsection (4) applies to dispositions and exchanges of securities by a taxpayer that occur after February 27, 2000.

(12) Subsection (7) applies after 1997, except that

(*a*) it does not apply to a right under an agreement to which subsection 7(7) of the Act, as enacted by S.C. 1999, c. 22, s. 3(7), does not (except for the purpose of applying paragraph 7(3)(*b*) of the Act) apply; and

(*b*) before 2000, the portion of subsection 7(7) of the Act, as enacted by subsection (7), before the definition "qualifying person" shall be read as:

"(7) The definitions in this subsection apply in this section and in paragraph 110(1)(*d*) and subsections 110(1.5) and (1.6)."

2. (1) Paragraph 8(1)(*c*) of the Act is replaced by the following:

Clergy residence

(*c*) where, in the year, the taxpayer

(i) is a member of the clergy or of a religious order or a regular minister of a religious denomination, and

(ii) is

(A) in charge of a diocese, parish or congregation,

(B) ministering to a diocese, parish or congregation, or

(C) engaged exclusively in full-time administrative service by appointment of a religious order or religious denomination,

the amount, not exceeding the taxpayer's remuneration for the year from the office or employment, equal to

(iii) the total of all amounts included in computing the taxpayer's income for the year under section 6 in respect of the residence or other living accommodation occupied by the taxpayer in the course of, or because of, the taxpayer's office or employment as such a member or minister so in charge of or ministering to a diocese, parish or congregation, or so engaged in such administrative service, or

(iv) rent paid by the taxpayer for the taxpayer's principal place of residence (or other principal living accommodation) ordinarily occupied during the year by the taxpayer, or the fair rental value of such a residence (or other living accommodation) owned by the taxpayer or the taxpayer's spouse or common-law partner, not exceeding the lesser of

(A) the greater of

(I) $1,000 multiplied by the number of months (to a maximum of ten) in the year, during which the taxpayer is a person described in subparagraphs (i) and (ii), and

(II) one-third of the taxpayer's remuneration for the year from the office or employment, and

(B) the amount, if any, by which

(I) the fair rental value of the residence or living accommodation

exceeds

(II) the total of all amounts each of which is an amount deducted, in connection with the same accommodation or residence, in computing an individual's income for the year from an office or employment or from a business (other than an amount deducted under this paragraph by the taxpayer), to the extent that the amount can reasonably be considered to relate to the period, or a portion of the period, in respect of which an amount is claimed by the taxpayer under this paragraph;

(2) Subsection 8(10) of the Act is replaced by the following:

Certificate of employer

(10) An amount otherwise deductible for a taxation year under paragraph (1)(*c*), (*f*), (*h*) or (*h*.1) or subparagraph (1)(*i*)(ii) or (iii) by a taxpayer shall not be deducted unless a prescribed form, signed by the taxpayer's employer certifying that the conditions set out in the applicable provision were met in the year in respect of the taxpayer, is filed with the taxpayer's return of income for the year.

(3) Subsections (1) and (2) apply to the 2001 and subsequent taxation years.

3. (1) Paragraph 12(1)(*i*.1) of the Act is replaced by the following:

Bad debts recovered

(*i*.1) where an amount is received in the year on account of a debt in respect of which a deduction for bad debts was made under subsection 20(4.2) in computing the taxpayer's income for a preceding taxation year, the amount determined by the formula

$$A \times B/C$$

where

A is 1/2 of the amount so received;

B is the amount that was deducted under subsection 20(4.2) in respect of the debt; and

C is the total of the amount that was so deducted under subsection 20(4.2) and the amount that was deemed by that subsection or subsection 20(4.3) to be an allowable capital loss in respect of the debt.

(2) Subsection 12(1) of the Act is amended by adding the following after paragraph (*o*):

Foreign oil and gas production taxes

(*o*.1) the total of all amounts, each of which is the taxpayer's production tax amount for a foreign oil and gas business of the taxpayer for the year, within the meaning assigned by subsection 126(7);

(3) Subsection (1) applies in respect of taxation years that end after February 27, 2000 except that, for taxation years that ended after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" in the description of A in paragraph 12(1)(*i*.1) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction "2/3".

(4) Subsection (2) applies to taxation years of a taxpayer that begin after the earlier of

(*a*) December 31, 1999; and

(*b*) where, for the purposes of subsection 72(9), a date is designated in writing by the taxpayer and the designation is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act receives royal assent, the later of

(i) the date so designated, and

(ii) December 31, 1994.

4. (1) Clause 13(7)(*b*)(ii)(B) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2" and by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(2) Clause 13(7)(*d*)(i)(B) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2" and by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(3) Paragraph 13(7)(*e*) of the Act is amended by replacing the references to the fraction "3/4" with references to the fraction "1/2" and by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(4) Subparagraph 13(7)(*f*)(ii) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(5) Subparagraph 13(21.1)(*b*)(ii) of the Act is amended by replacing the reference to the fraction "1/4" with a reference to the fraction "1/2".

(6) Subsections (1) and (2) apply to changes in use of property that occur in taxation years that end after February 27, 2000 except that, for changes in use of property that occur in a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the references in clauses 13(7)(*b*)(ii)(B) and 13(7)(*d*)(i)(B) of the Act, as enacted by subsections (1) and (2), respectively, to the fraction "1/2" shall be read as references to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year and the references to the word "twice" shall be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year, multiplied by".

(7) Subsection (3) applies to acquisitions of property that occur in taxation years that end after February 27, 2000 except that, for acquisitions of property in a taxation year that includes either February 28, 2000 or October 17, 2000 of a person or partnership from whom the property was acquired, the references in paragraph 13(7)(*e*) of the Act, as enacted by subsection (3), to the fraction "1/2" shall be read as references to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the person or partnership from whom the taxpayer acquired the property for the year in which the person or partnership disposed of the property, and the references to the word "twice" shall be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the person or partnership from whom the taxpayer acquired the property for the year in which the person or partnership disposed of the property, multiplied by".

(8) Subsection (4) applies to acquisitions of property that occur in taxation years that end after February 27, 2000 except that, for acquisitions of property that occur in a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the reference in subparagraph 13(7)(*f*)(ii) of the Act, as enacted by subsection (4), to the fraction "1/2" shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year.

(9) Subsection (5) applies to taxation years that end after February 27, 2000 except that, for a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the reference in subparagraph 13(21.1)(*b*)(ii) of the Act, as enacted by subsection (5), to the fraction "1/2" shall be read as a reference to the fraction determined when the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year is subtracted from 1.

5. (1) Subsection 14(1) of the Act is replaced by the following:

Eligible capital property – inclusion in income from business

14. (1) Where, at the end of a taxation year, the total of all amounts each of which is an amount determined, in respect of a business of a taxpayer, for E in the definition "cumulative eligible capital" in subsection (5) (in this section referred to as an "eligible capital amount") or for F in that definition exceeds the total of all amounts determined for A to D in that definition in respect of the business (which excess is in this subsection referred to as "the excess"), there shall be included in computing the taxpayer's income from the business for the year <u>the total of</u>

(<u>*a*</u>) the amount, if any, that is the lesser of

<u>(i)</u> the excess, and

<u>(ii)</u> the amount determined for F in the definition "cumulative eligible capital" in subsection (5) at the end of the year in respect of the business, and

(<u>*b*</u>) the amount, if any, determined by the formula

$$\underline{2/3} \times (A - B - C - D)$$

where

A is the excess,

B is the amount determined for F in the definition "cumulative eligible capital" in subsection (5) at the end of the year in respect of the business,

C is 1/2 of the amount determined for Q in the definition "cumulative eligible capital" in subsection (5) at the end of the year in respect of the business, and

D is the amount claimed by the taxpayer, not exceeding the taxpayer's exempt gains balance for the year in respect of the business.

Election re: capital gain

(1.01) Where, at any time in a taxation year, a taxpayer disposes of an eligible capital property (other than goodwill) in respect of a business, the cost of the property to the taxpayer can be determined, the proceeds of the disposition (in this subsection referred to as the "actual proceeds") exceed that cost, the taxpayer's exempt gains balance in respect of the business for the year is nil and the taxpayer so elects under this subsection in the taxpayer's return of income for the year,

(*a*) for the purposes of subsection (5), the proceeds of disposition of the property are deemed to be equal to that cost;

(*b*) the taxpayer is deemed to have disposed at that time, of a capital property that had at that time an adjusted cost base to the taxpayer equal to that cost, for proceeds of disposition equal to the actual proceeds; and

(*c*) where the eligible capital property is at that time a qualified farm property (within the meaning assigned by subsection 110.6(1)) of the taxpayer, the capital property deemed by paragraph (*b*) to have been disposed of by the taxpayer is deemed to have been at that time a qualified farm property of the taxpayer.

(2) The portion of subsection 14(1.1) of the Act before the description of B in paragraph (*b*) is replaced by the following:

Deemed taxable capital gain

(1.1) For the purposes of section 110.6 and paragraph 3(*b*) as it applies for the purposes of that section, an amount included under paragraph (1)(*b*) in computing a taxpayer's income for a particular taxation year from a business is deemed to be a taxable capital gain of the taxpayer for the year from the disposition in the year of qualified farm property to the extent of the lesser of

(*a*) the amount included under paragraph (1)(*b*) in computing the taxpayer's income for the particular year from the business, and

(*b*) the amount determined by the formula

$$A - B$$

where

A is the amount by which the total of

(i) 3/4 of the total of all amounts each of which is the taxpayer's proceeds from a disposition in a preceding taxation year that began after 1987 and ended before February 28, 2000 of eligible capital property in respect of the business that, at the time of the disposition, was a qualified farm property (within the meaning assigned by subsection 110.6(1)) of the taxpayer,

(ii) 2/3 of the total of all amounts each of which is the taxpayer's proceeds from a disposition in the particular year or a preceding taxation year that ended after February 27, 2000 and before October 18, 2000 of eligible capital property in respect of the business that, at the time of the disposition, was a qualified farm property (within the meaning assigned by subsection 110.6(1)) of the taxpayer, and

(iii) 1/2 of the total of all amounts each of which is the taxpayer's proceeds from a disposition in the particular year or a preceding taxation year that ended after October 17, 2000 of eligible capital property in respect of the business that, at the time of the disposition, was a qualified farm property (within the meaning assigned by subsection 110.6(1)) of the taxpayer

exceeds the total of

(iv) 3/4 of the total of all amounts each of which is

(A) an eligible capital expenditure of the taxpayer in respect of the business that was made or incurred in respect of a qualified farm property disposed of by the taxpayer in a preceding taxation year that began after 1987 and ended before February 28, 2000, or

(B) an outlay or expense of the taxpayer that was not deductible in computing the taxpayer's income and that was made or incurred for the purpose of making a disposition referred to in clause (A),

(v) 2/3 of the total of all amounts each of which is

(A) an eligible capital expenditure of the taxpayer in respect of the business that was made or incurred in respect of a qualified farm property disposed of by the taxpayer in the particular year or a preceding taxation year that ended after February 27, 2000 and before October 18, 2000, or

(B) an outlay or expense of the taxpayer that was not deductible in computing the taxpayer's income and that was made or incurred for the purpose of making a disposition referred to in clause (A), and

(vi) 1/2 of the total of all amounts each of which is

(A) an eligible capital expenditure of the taxpayer in respect of the business that was made or incurred in respect of a qualified farm property disposed of by the taxpayer in the particular year or a preceding taxation year that ended after October 17, 2000, or

(B) an outlay or expense of the taxpayer that was not deductible in computing the taxpayer's income and that was made or incurred for the purpose of making a disposition referred to in clause (A), and

(3) The portion of subsection 14(3) of the Act before paragraph (*c*) is replaced by the following:

Acquisition of eligible capital property

(3) Notwithstanding any other provision of this Act, where at any particular time a person or partnership (in this subsection referred to as the "taxpayer") has, directly or indirectly, in any manner whatever, acquired an eligible capital property in respect of a business from a

person or partnership with which the taxpayer did not deal at arm's length (in this subsection referred to as the "transferor") and the property was an eligible capital property of the transferor (other than property acquired by the taxpayer as a consequence of the death of the transferor), the eligible capital expenditure of the taxpayer in respect of the business is, in respect of that acquisition, deemed to be equal to 4/3 of the amount, if any, by which

(*a*) the amount determined for E in the definition "cumulative eligible capital" in subsection (5) in respect of the disposition of the property by the transferor

exceeds the total of

(*b*) the total of all amounts that can reasonably be considered to have been claimed as deductions under section 110.6 for taxation years that ended before February 28, 2000 by any person with whom the taxpayer was not dealing at arm's length in respect of the disposition of the property by the transferor, or any other disposition of the property before the particular time,

(*b*.1) 9/8 of the total of all amounts that can reasonably be considered to have been claimed as deductions under section 110.6 for taxation years that ended after February 27, 2000 and before October 18, 2000 by any person with whom the taxpayer was not dealing at arm's length in respect of the disposition of the property by the transferor, or any other disposition of the property before the particular time, and

(*b*.2) 3/2 of the total of all amounts that can reasonably be considered to have been claimed as deductions under section 110.6 for taxation years that end after October 17, 2000 by any person with whom the taxpayer was not dealing at arm's length in respect of the disposition of the property by the transferor, or any other disposition of the property before that particular time,

except that, where the taxpayer disposes of the property after that particular time, the amount of the eligible capital expenditure deemed by this subsection to be made by the taxpayer in respect of the property shall be determined at any time after the disposition as if the total of the amounts determined under paragraphs (*b*), (*b*.1) and (*b*.2) in respect of the disposition were the lesser of

(4) The description of B in the definition "cumulative eligible capital" in subsection 14(5) of the Act is replaced by the following:

B is the total of

(*a*) 3/2 of all amounts included under paragraph (1)(*b*) in computing the taxpayer's income from the business for taxation years that ended before that time and after October 17, 2000,

(*b*) 9/8 of all amounts included under paragraph (1)(*b*) in computing the taxpayer's income from the business for taxation years that ended

(i) before that time, and

(ii) after February 27, 2000 and before October 18, 2000,

(*c*) all amounts included under paragraph (1)(*b*) in computing the taxpayer's income from the business for taxation years that ended

(i) before the earlier of that time and February 28, 2000, and

(ii) after the taxpayer's adjustment time,

(*d*) all amounts each of which is the amount that would have been included under subparagraph (1)(*a*)(v) in computing the taxpayer's income from the business, if the amount determined for D in that subparagraph for the year were nil, for taxation years that ended

(i) before the earlier of that time and February 28, 2000, and

(ii) after February 22, 1994, and

(*e*) all taxable capital gains included, because of the application of subparagraph (1)(*a*)(v) to the taxpayer in respect of the business, in computing the taxpayer's income for taxation years that began before February 23, 1994,

(5) The description of R in the definition "cumulative eligible capital" in subsection 14(5) of the Act is replaced by the following:

R is the total of all amounts included, in computing the taxpayer's income from the business for taxation years that ended before that time and after the taxpayer's adjustment time, under subparagraph (1)(*a*)(iv) in respect of taxation years that ended before February 28, 2000 and under paragraph (1)(*a*) in respect of taxation years that end after February 27, 2000;

(6) Subsections (1) to (5) apply in respect of taxation years that end after February 27, 2000 except that, for taxation years that ended after February 27, 2000 and before October 18, 2000, the reference to the fraction "2/3" in the formula in paragraph 14(1)(*b*) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction "8/9".

6. (1) Paragraph 18(3.1)(*b*) of the Act is replaced by the following:

(*b*) the amount of such an outlay or expense shall, to the extent that it would otherwise be deductible in computing the taxpayer's income for the year, be included in computing the cost or capital cost, as the case may be, of the building to the taxpayer, to the person with whom the taxpayer does not deal at arm's length, to the corporation of which the taxpayer is a specified shareholder or to the partnership of which the taxpayer's share of any income or loss is 10% or more, as the case may be.

(2) Paragraph 18(4)(*a*) of the Act is replaced by the following:

(*a*) the amount, if any, by which

(i) the average of all amounts each of which is, in respect of a calendar month that ends in the year, the greatest total amount at any time in the month of the corporation's outstanding debts to specified non-residents,

exceeds

(ii) two times the total of

(A) the retained earnings of the corporation at the beginning of the year, except to the extent that those earnings include retained earnings of any other corporation,

(B) the average of all amounts each of which is the corporation's contributed surplus at the beginning of a calendar month that ends in the year, to the extent that it was contributed by a specified non-resident shareholder of the corporation, and

(C) the average of all amounts each of which is the corporation's paid-up capital at the beginning of a calendar month that ends in the year, excluding the paid-up capital in respect of shares of any class of the capital stock of the corporation owned by a person other than a specified non-resident shareholder of the corporation,

(3) Subsection 18(8) of the Act is repealed.

(4) Subsection (1) applies to outlays and expenses made or incurred after ANNOUNCEMENT DATE.

(5) Subsections (2) and (3) apply to taxation years that begin after 2000.

7. (1) Paragraph 20(1)(*b*) of the Act is replaced by the following:

Cumulative eligible capital amount

(*b*) such amount as the taxpayer claims in respect of a business, not exceeding 7% of the taxpayer's cumulative eligible capital in respect of the business at the end of the year except that, where the year is less than 12 months, the amount allowed as a deduction under this paragraph shall not exceed that proportion of the maximum amount otherwise allowable that the number of days in the taxation year is of 365;

(2) Subparagraph 20(1)(*f*)(ii) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(3) Paragraph 20(1)(*z*.1) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(4) Subparagraph 20(1)(*hh*)(ii) of the Act is replaced by the following:

(ii) that is, by reason of subparagraph 12(1)(*x*)(vi) or subsection 12(2.2), not included under paragraph 12(1)(*x*) in computing the taxpayer's income for the year or a preceding taxation year, where the particular amount relates to an outlay or expense (other than an outlay or expense that is in respect of the cost of property of the taxpayer or that is or would be, if amounts deductible by the taxpayer were not limited by reason of paragraph 66(4)(*b*), subsection 66.1(2), subparagraph 66.2(2)(*a*)(ii), the words "30% of" in clause 66.21(4)(*a*)(ii)(B), clause 66.21(4)(a)(ii)(C) or (D) or subparagraph 66.4(2)(*a*)(ii), deductible under section 66, 66.1, 66.2, 66.21 or 66.4) that would, if the particular amount had not been received, have been deductible in computing the taxpayer's income for the year or a preceding taxation year;

(5) Subsection 20(4.2) of the Act is replaced by the following:

Bad debts re: eligible capital property

(4.2) Where, in respect of one or more dispositions of eligible capital property by a taxpayer, an amount that is described in paragraph (*a*) of the description of E in the definition "cumulative eligible capital" in subsection 14(5) in respect of the taxpayer is established by the taxpayer to have become a bad debt in a taxation year, there shall be deducted in computing the taxpayer's income for the year the amount determined by the formula

$$(A + B) - (C + D + E + F + G + H)$$

where

A is the lesser of

(*a*) 1/2 of the total of all amounts each of which is such an amount that was so established to have become a bad debt in the year or a preceding taxation year, and

(*b*) the amount that is

(i) where the year ended after February 27, 2000, the amount, if any, that would be the total of all amounts determined by the formula in paragraph 14(1)(*b*) (if that formula were read without reference to the description of D) for the year, or for a preceding taxation year that ended after February 27, 2000, and

(ii) where the year ended before February 28, 2000, nil;

B is the amount, if any, by which

(*a*) 3/4 of the total of all amounts each of which is such an amount that was so established to be a bad debt in the year or a preceding taxation year

exceeds the total of

(*b*) 3/2 of the amount by which

(i) the value of A

exceeds

(ii) the amount included in the value of A because of subparagraph (*b*)(i) of the description of A in respect of taxation years that ended after February 27, 2000 and before October 18, 2000, and

(*c*) 9/8 of the amount included in the value of A because of subparagraph (*b*)(i) of the description of A in respect of taxation years that ended after February 27, 2000 and before October 18, 2000;

C is the total of all amounts each of which is an amount determined under subsection 14(1) or (1.1) for the year, or a preceding taxation year, that ends after October 17, 2000 and in respect of which a deduction can reasonably be considered to have been claimed under section 110.6 by the taxpayer;

D is the total of all amounts each of which is an amount determined under subsection 14(1) or (1.1) for the year, or a preceding taxation year, that ended after February 27, 2000 and before October 18, 2000 and in respect of which a deduction can reasonably be considered to have been claimed under section 110.6 by the taxpayer;

E is the total of all amounts each of which is an amount determined under subsection 14(1) or (1.1) for a preceding taxation year that ended before February 28, 2000 and in respect of which a deduction can reasonably be considered to have been claimed under section 110.6 by the taxpayer;

F is the total of

(*a*) 2/3 of the total of all amounts each of which is the value determined in respect of the taxpayer for D in the formula in paragraph 14(1)(*b*) for the year, or a preceding taxation year, that ends after October 17, 2000, and

(*b*) 8/9 of the total of all amounts each of which is the value determined in respect of the taxpayer for D in the formula in paragraph 14(1)(*b*) for the year, or a preceding taxation year, that ended after February 27, 2000 and before October 18, 2000;

G is the total of all amounts each of which is the value determined in respect of the taxpayer for D in the formula in subparagraph 14(1)(*a*)(v) (as that subparagraph applied for taxation years that ended before February 28, 2000) for a preceding taxation year; and

H is the total of all amounts deducted by the taxpayer under this subsection for preceding taxation years.

Deemed allowable capital loss

(4.3) Where, in respect of one or more dispositions of eligible capital property by a taxpayer, an amount that is described in paragraph (*a*) of the description of E in the definition "cumulative eligible capital" in subsection 14(5) in respect of the taxpayer is established by the taxpayer to have become a bad debt in a taxation year, the taxpayer is deemed to have an allowable capital loss from a disposition of capital property in the year equal to the lesser of

(*a*) the total of the value determined for A and 2/3 of the value determined for B in the formula in subsection (4.2) in respect of the taxpayer for the year; and

(*b*) the total of all amounts each of which is

(i) the value determined for C or paragraph (*a*) of the description of F in the formula in subsection (4.2) in respect of the taxpayer for the year,

(ii) 3/4 of the value determined for D or paragraph (*b*) of the description of F in the formula in subsection (4.2) in respect of the taxpayer for the year, or

(iii) 2/3 of the value determined for E or G in the formula in subsection (4.2) in respect of the taxpayer for the year.

(6) Subsection (1) applies to taxation years that begin after ANNOUNCEMENT DATE.

(7) Subsections (2) and (3) apply in respect of amounts that become payable after February 27, 2000 except that, for amounts that became payable after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" in subparagraph 20(1)(*f*)(ii) of the Act, as enacted by subsection (2), and in paragraph 20(1)(*z*.1) of the Act, as enacted by subsection (3), shall be read as a reference to the fraction "2/3".

(8) Subsection (4) applies to taxation years that begin after 2000.

(9) Subsection (5) applies in respect of taxation years that end after February 27, 2000 except that, for taxation years that ended after February 27, 2000 and before October 18, 2000,

(*a*) the reference to the fraction "1/2" in paragraph (*a*) of the description of A in subsection 20(4.2) of the Act, as enacted by subsection (5), shall be read as a reference to the fraction "2/3";

(*b*) the reference to the fraction "3/2" in the description of B in subsection 20(4.2) of the Act, as enacted by subsection (5), shall be read as a reference to the fraction "9/8";

(*c*) the reference to the fraction "2/3" in paragraph 20(4.3)(*a*) and subparagraph 20(4.3)(*b*)(iii) of the Act, as enacted by subsection (5), shall be read as a reference to the fraction "8/9"; and

(*d*) subparagraph 20(4.3)(*b*)(ii) of the Act, as enacted by subsection (5), shall be read without reference to the expression "3/4 of".

8. (1) The Act is amended by adding the following after section 20.2:

Weak currency debt – interpretation

20.3 (1) The definitions in this subsection apply in this section.

"exchange date"
« date de l'échange »

"exchange date" in respect of a weak currency debt of a taxpayer means, if the debt is incurred or assumed by the taxpayer

(*a*) in respect of borrowed money that is denominated in the final currency, the debt that is incurred or assumed by the taxpayer; and

(*b*) in respect of borrowed money that is not denominated in the final currency, or in respect of the acquisition of property, the day on which the taxpayer uses the borrowed money or the acquired property, directly or indirectly, to acquire funds that are, or to settle an obligation that is, denominated in the final currency.

"hedge"
« opération de couverture »

"hedge" in respect of a weak currency debt owing by a taxpayer means any agreement made by the taxpayer

(*a*) that can reasonably be regarded as having been made by the taxpayer primarily to reduce the taxpayer's risk, with respect to payments of principal or interest in respect of the debt, of fluctuations in the value of the weak currency; and

(*b*) that is identified by the taxpayer as a hedge in respect of the debt in a designation in prescribed form filed with the Minister on or before the 30th day after the day the taxpayer enters into the agreement.

"weak currency debt"
« dette en devise faible »

"weak currency debt" of a taxpayer means a debt in a foreign currency (in this section referred to as the "weak currency"), incurred or assumed by the taxpayer at a particular time after February 27, 2000, in respect of a borrowing of money or an acquisition of property,

(*a*) where

(i) the borrowed money is denominated in a currency (in this section referred to as the "final currency") other than the weak currency, is used for the purpose of earning income from a business or property and is not used to acquire funds in a currency other than the final currency,

(ii) the borrowed money or the acquired property is used, directly or indirectly, to acquire funds that are denominated in a currency (in this section referred to as the "final currency") other than the weak currency, that are used for the purpose of earning income from a business or property and that are not used to acquire funds in a currency other than the final currency, or

(iii) the borrowed money or the acquired property is used, directly or indirectly, to settle an obligation that is denominated in a currency (in this section referred to as the "final currency") other than the weak currency, that is incurred or assumed for the purpose of earning income from a business or property and that is not incurred or assumed to acquire funds in a currency other than the final currency;

(*b*) where the amount of the debt (together with any other debt that would, but for this paragraph, be a weak currency debt, and that can reasonably be regarded as having been incurred or assumed by the taxpayer as part of a series of transactions that includes the incurring or assumption of the debt) exceeds $500,000; and

(*c*) where the rate at which interest is payable in the weak currency in respect of the debt exceeds by more than two

percentage points the rate at which interest would have been payable in the final currency if at the particular time the taxpayer had instead incurred or assumed an equivalent amount of debt in the final currency on the same terms (other than the rate of interest), with such modifications as the difference in currency requires.

Interest and gain

(2) Notwithstanding any other provision of this Act, the following rules apply in respect of a weak currency debt of a taxpayer (other than a corporation described in one or more of paragraphs (*a*), (*b*), (*c*) and (*e*) of the definition "specified financial institution" in subsection 248(1)):

(*a*) no deduction on account of interest that accrues on the debt after the day that is the later of June 30, 2000 and the exchange date shall exceed the amount of interest that would, if at the time of incurring or assuming the debt the taxpayer had instead incurred or assumed an equivalent amount of debt, the principal and interest in respect of which were denominated in the final currency, on the same terms (other than the rate of interest and with such other modifications as the difference in currency requires), have accrued on the equivalent debt after that day;

(*b*) the amount, if any, of the taxpayer's gain or loss (in this section referred to as a "foreign exchange gain or loss") for a taxation year

(i) on the settlement or extinguishment of the debt, or

(ii) on the performance or settlement of any hedge in respect of the debt

that arises because of the fluctuation in the value of any currency shall be included or deducted, as the case may be, in computing the taxpayer's income for the year from the business or the property to which the debt relates; and

(*c*) the amount of any interest on the debt that was, because of this subsection, not deductible is deemed, for the purpose of computing the taxpayer's foreign exchange gain or loss on the settlement or extinguishment of the debt, to be an amount paid by the taxpayer to settle or extinguish the debt.

Hedges

(3) In applying subsection (2) in circumstances where a taxpayer has entered into a hedge in respect of a weak currency debt, the amount

paid or payable in the weak currency for a taxation year on account of interest on the debt, or paid in the weak currency in the year on account of the debt's principal, shall be decreased by the amount of any foreign exchange gain, or increased by the amount of any foreign exchange loss, on the hedge in respect of the amount so paid or payable.

Repayment of principal

(4) If the amount (expressed in the weak currency) outstanding on account of principal in respect of a particular weak currency debt is reduced before maturity (whether by repayment or otherwise), the amount (expressed in the weak currency) of the reduction is deemed, except for the purposes of determining the rate of interest that would have been charged on an equivalent loan in the final currency and applying paragraph (*b*) of the definition "weak currency debt" in subsection (1), to have been a separate debt from the time the debt was incurred or assumed by the taxpayer.

(2) Subsection (1) applies to taxation years that end after February 27, 2000.

(3) A designation described in paragraph (*b*) of the definition "hedge" in subsection 20.3(1) of the Act, as enacted by subsection (1), is deemed to have been filed in a timely manner if it is filed on or before the later of July 31, 2000 and the 30th day after the day the taxpayer agrees to the hedge.

9. (1) Subsection 21(2) of the Act is replaced by the following:

Borrowed money used for exploration or development

(2) Where in a taxation year a taxpayer has used borrowed money for the purpose of exploration, development or the acquisition of property and the expenses incurred by the taxpayer in respect of those activities are Canadian exploration and development expenses, Canadian exploration expenses, Canadian development expenses, Canadian oil and gas property expenses, foreign resource expenses in respect of a country, or foreign exploration and development expenses, as the case may be, if the taxpayer so elects under this subsection in the taxpayer's return of income for the year,

(*a*) in computing the taxpayer's income for the year and for such of the three immediately preceding taxation years as the taxpayer had, paragraphs 20(1)(*c*), (*d*), (*e*) and (*e*.1) do not apply to the amount or

to the part of the amount specified in the taxpayer's election that, but for that election, would be deductible in computing the taxpayer's income (other than exempt income or income that is exempt from tax under this Part) for any such year in respect of the borrowed money used for the exploration, development or acquisition of property, as the case may be; and

(*b*) the amount or the part of the amount, as the case may be, described in paragraph (*a*) is deemed to be Canadian exploration and development expenses, Canadian exploration expenses, Canadian development expenses, Canadian oil and gas property expenses, foreign resource expenses in respect of a country, or foreign exploration and development expenses, as the case may be, incurred by the taxpayer in the year.

(2) Subsection 21(4) of the Act is amended by striking out the word "and" at the end of paragraph (*a*) and by replacing the portion after that paragraph with the following:

(*b*) in each taxation year, if any, after that preceding taxation year and before the particular year, made an election under this subsection covering the total amount that, but for that election, would have been deductible in computing the taxpayer's income (other than exempt income or income that is exempt from tax under this Part) for each such year in respect of the borrowed money used for the exploration, development or acquisition of property, as the case may be, and

(*c*) so elects in the taxpayer's return of income for the particular year,

the following rules apply:

(*d*) paragraphs 20(1)(*c*), (*d*), (*e*) and (*e*.1) do not apply to the amount or to the part of the amount specified in the election that, but for the election, would be deductible in computing the taxpayer's income (other than exempt income or income that is exempt from tax under this Part) for the particular year in respect of the borrowed money used for the exploration, development or acquisition of property, and

(*e*) the amount or part of the amount, as the case may be, is deemed to be Canadian exploration and development expenses, Canadian exploration expenses, Canadian development expenses, Canadian oil and gas property expenses, foreign resource expenses in respect of a country, or foreign exploration and development expenses, as the case may be, incurred by the taxpayer in the particular year.

(3) Subsections (1) and (2) apply to taxation years that begin after 2000.

10. (1) Paragraph 24(2)(*d*) of the Act is replaced by the following:

(*d*) for the purpose of determining after that time the amount required to be included under paragraph 14(1)(*b*) in computing the income of the spouse, the common-law partner or the corporation in respect of any subsequent disposition of property of the business, there shall be added to the amount otherwise determined for Q in the definition "cumulative eligible capital" in subsection 14(5) the amount, if any, determined for Q in that definition in respect of the business of the individual immediately before the individual ceased to carry on business.

(2) Subsection (1) applies in respect of taxation years that end after February 27, 2000.

11. (1) The definition "mining property" in subsection 35(2) of the Act is replaced by the following:

"mining property"
« *bien minier* »

"mining property" means

(*a*) a right, licence or privilege to prospect, explore, drill or mine for minerals in a mineral resource in Canada, or

(*b*) real property in Canada (other than depreciable property) the principal value of which depends on its mineral resource content;

(2) Subsection (1) applies to shares received after ANNOUNCEMENT DATE.

12. (1) Subsection 37(1) of the Act is amended by adding the following after paragraph (*d*):

(*d*.1) the total of all amounts each of which is the super-allowance benefit amount (within the meaning assigned by subsection 127(9)) for the year or for a preceding taxation year in respect of the taxpayer in respect of a province,

(2) Subsection (1) applies to taxation years that begin after February 2000 except that, if a taxpayer's first taxation year that begins after February 2000 ends before 2001, subsection (1) applies to the taxpayer's taxation years that begin after 2000.

13. (1) Paragraph 38(*a*) of the Act is replaced by the following:

(*a*) subject to paragraphs (*a*.1) and (*a*.2), a taxpayer's taxable capital gain for a taxation year from the disposition of any property is 1/2 of the taxpayer's capital gain for the year from the disposition of the property;

(2) Paragraph 38(*a*.1) of the Act is amended by replacing the reference to the fraction "3/8" with a reference to the fraction "1/4".

(3) Section 38 of the Act is amended by adding the following after paragraph (*a*.1):

(*a*.2) a taxpayer's taxable capital gain for a taxation year from the disposition of a property is 1/4 of the taxpayer's capital gain for the year from the disposition of the property where

(i) the disposition is the making of a gift to a qualified donee (other than a private foundation) of a property described, in respect of the taxpayer, in paragraph 110.1(1)(*d*) or in the definition "total ecological gifts" in subsection 118.1(1), or

(ii) the disposition is deemed by section 70 to have occurred and the taxpayer is deemed by subsection 118.1(5) to have made a gift described in subparagraph (i) of the property;

(4) Paragraphs 38(*b*) and (*c*) of the Act are amended by replacing the references to the fraction "3/4" with references to the fraction "1/2".

(5) Subsections (1) and (4) apply to the 2000 and subsequent taxation years except that

(*a*) for a taxation year of a taxpayer that ended before February 28, 2000, the references to the fraction "1/2" in paragraph 38(*a*) of the Act, as enacted by subsection (1), and in paragraphs 38(*b*) and (*c*) of the Act, as enacted by subsection (4), shall be read as references to the fraction "3/4",

(*b*) for a taxation year of a taxpayer that includes February 28, 2000 but does not include October 18, 2000, the references to the fraction "1/2" in paragraph 38(*a*) of the Act, as enacted by subsection (1), and in paragraphs 38(*b*) and (*c*) of the Act, as enacted by subsection (4), shall be read as references to the fraction that applies to the taxpayer for that year, and for this purpose,

(i) where the amount of the taxpayer’s net capital gains from dispositions of property in the period that began at the beginning of the year and ended at the end of February 27, 2000 (in this paragraph referred to as the "first period") exceeds the amount of the taxpayer’s net capital losses from dispositions of property in the period that begins at the beginning of February 28, 2000 and ends at the end of the year (in this paragraph referred to as the "second period"), the fraction that applies to the taxpayer for the year is 3/4,

(ii) where the amount of the taxpayer’s net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer’s net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 3/4,

(iii) where the amount of the taxpayer’s net capital gains from dispositions of property in the first period is less than the amount of the taxpayer’s net capital losses from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3,

(iv) where the amount of the taxpayer’s net capital losses from dispositions of property in the first period is less than the amount of the taxpayer’s net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3,

(v) where the taxpayer has only net capital gains, or only net capital losses, from dispositions of property in each of the first and second periods, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(3/4\ A + 2/3\ B) / (A+B)$$

where

A is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the first period, and

B is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the second period, and

(vi) where the net capital gains and net capital losses of the taxpayer for the year is nil, the fraction that applies to the taxpayer for the year is 2/3,

(*c*) for a taxation year of a taxpayer that began after February 27, 2000 and includes October 18, 2000, the references to the fraction "1/2" in paragraph 38(*a*) of the Act, as enacted by subsection (1), and in paragraphs 38(*b*) and (*c*) of the Act, as enacted by subsection (4), shall be read as references to the fraction that applies to the taxpayer for that year, and for this purpose,

(i) where the amount of the taxpayer's net capital gains from dispositions of property in the period that began at the beginning of the year and ended at the end of October 17, 2000 (in this paragraph referred to as the "first period") exceeds the amount of the taxpayer's net capital losses from dispositions of property in the period that begins at the beginning of October 18, 2000 and ends at the end of the year (in this paragraph referred to as the "second period"), the fraction that applies to the taxpayer for the year is 2/3,

(ii) where the amount of the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3,

(iii) where the amount of the taxpayer's net capital gains from dispositions of property in the first period is less than the amount of the taxpayer's net capital losses from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 1/2,

(iv) where the amount of the taxpayer's net capital losses from dispositions of property in the first period is less than the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 1/2,

(v) where the taxpayer has only net capital gains, or only net capital losses, from dispositions of property in each of the first and second periods, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(2/3\ A + 1/2\ B) / (A+B)$$

where

A is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the first period, and

B is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the second period, and

(vi) where the net capital gains and net capital losses of the taxpayer for the year is nil, the fraction that applies to the taxpayer for the year is 1/2,

(*d*) for a taxation year of a taxpayer that includes February 27, 2000 and October 18, 2000, the references to the fraction "1/2" in paragraph 38(*a*) of the Act, as enacted by subsection (1), and in paragraphs 38(*b*) and (*c*) of the Act, as enacted by subsection (4), shall be read as references to the fraction that applies to the taxpayer for that year, and for this purpose,

(i) where

(A) the amount by which the amount of the taxpayer's net capital gains from dispositions of property in the period that began at the beginning of the year and ended at the end of February 27, 2000 (in this paragraph referred to as the "first period") exceeds the amount of the taxpayer's net capital losses from dispositions of property in the period that began at the beginning of February 28, 2000 and ended at the end of October 17, 2000 (in this paragraph referred to as the "second period")

exceeds

(B) the amount of the taxpayer's net capital losses from dispositions of property in the period that begins at the beginning of October 18, 2000 and ends at the end of the year (in this paragraph referred to as the "third period"),

the fraction that applies to the taxpayer for the year is 3/4,

(ii) where

(A) the amount by which the amount of the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period

exceeds

(B) the amount of the taxpayer's net capital gains from dispositions of property in the third period

the fraction that applies to the taxpayer for the year is 3/4,

(iii) where

(A) the amount by which the amount of the taxpayer's net capital gains from dispositions of property in the second period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the first period

exceeds

(B) the amount of the taxpayer's net capital losses from dispositions of property in the third period

the fraction that applies to the taxpayer for the year is 2/3,

(iv) where

(A) the amount by which the amount of the taxpayer's net capital losses from dispositions of property in the second period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the first period

exceeds

(B) the amount of the taxpayer's net capital gains from dispositions of property in the third period

the fraction that applies to the taxpayer for the year is 2/3,

(v) where the taxpayer has net capital gains in each of the first and second periods and the aggregate of the amount of those net capital gains in those periods exceeds the amount of the taxpayer's net capital losses in the third period, the fraction that applies to the taxpayer for the year is the fraction that is determined by the formula

$$(3/4\ A + 2/3\ B) / (A+B)$$

where

A is the net capital gains of the taxpayer from dispositions of property in the first period, and

B is the net capital gains of the taxpayer from dispositions of property in the second period,

(vi) where the taxpayer has net capital losses in each of the first and second periods and the aggregate of the amount of those net capital losses in those periods exceeds the amount of the taxpayer's net capital gains in the third period, the fraction that applies to the taxpayer for the year is the fraction that is determined by the formula

$$(3/4\ A + 2/3\ B)\ /\ (A+B)$$

where

A is the net capital losses of the taxpayer from dispositions of property in the first period, and

B is the net capital losses of the taxpayer from dispositions of property in the second period,

(vii) where the taxpayer has only net capital gains, or only net capital losses, from dispositions of property in each of the first, second and third periods, the fraction that applies to the taxpayer for the year is the fraction that is determined by the formula

$$(3/4\ A + 2/3\ B + 1/2\ C)\ /\ (A+B+C)$$

where

A is the taxpayer's net capital gains or net capital losses, as the case may be, from dispositions of property in the first period,

B is the taxpayer's net capital gains or net capital losses, as the case may be, from dispositions of property in the second period, and

C is the taxpayer's net capital gains or net capital losses, as the case may be, from dispositions of property in the third period,

(viii) where the amount of the taxpayer's net capital gains from dispositions of property in the first period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the second period and the taxpayer has net capital gains from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction that is determined by the formula

$$(3/4\ A + 1/2\ B)\ /\ (A+B)$$

where

A is the amount by which the taxpayer's net capital gains from dispositions of property in the first period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the second period, and

B is the taxpayer's net capital gains from dispositions of property in the third period,

(ix) where the amount of the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period and the taxpayer has net capital losses from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction that is determined by the formula

$$(3/4\ A + 1/2\ B) / (A+B)$$

where

A is the amount by which the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period, and

B is the taxpayer's net capital losses from dispositions of property in the third period,

(x) where the amount of the taxpayer's net capital gains from dispositions of property in the second period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the first period and the taxpayer has net capital gains from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction that is determined by the formula

$$(2/3\ A + 1/2\ B) / (A+B)$$

where

A is the amount by which the taxpayer's net capital gains from dispositions of property in the second period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the first period, and

B is the taxpayer's net capital gains from dispositions of property in the third period,

(xi) where the amount of the taxpayer's net capital losses from dispositions of property in the second period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the first period and the taxpayer has net capital losses from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction that is determined by the formula

$$(2/3\ A + 1/2\ B)\ /\ (A+B)$$

where

A is the amount by which the taxpayer's net capital losses from dispositions of property in the second period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the first period, and

B is the taxpayer's net capital losses from dispositions of property in the third period, and

(xii) in any other case, the fraction that applies to the taxpayer for the year is 1/2, and

in determining the fraction that applies to the taxpayer under paragraphs (*a*) to (*d*) for the year, the following rules apply:

(*e*) the net capital gains of a taxpayer from dispositions of property in a period is the amount, if any, by which the taxpayer's capital gains from dispositions of property in the period exceeds the taxpayer's capital losses from dispositions of property in the period,

(*f*) the net capital losses of a taxpayer from dispositions of property in a period is the amount, if any, by which the taxpayer's capital losses from dispositions of property in the period exceeds the taxpayer's capital gains from dispositions of property in the period,

(*g*) the net amount included as a capital gain of the taxpayer for a taxation year from a disposition to which paragraph 38(*a*.2) of the Act, as enacted by subsection (3), applies or from a disposition to which paragraph 38(*a*.1) of the Act, as enacted by subsection (2), applies, is deemed to be equal to one half of the capital gain,

(*h*) the net amount included as a capital gain of the taxpayer for a taxation year from a disposition of property before the year because of subparagraphs 40(1)(*a*)(ii) and (iii) of the Act is deemed to be a capital gain of the taxpayer from a disposition of property on the first day of the year,

(*i*) each capital loss that is a business investment loss shall be determined without reference to subsections 39(9) and (10) of the Act,

(*j*) where an amount is included in computing the income of the taxpayer for the year because of subsection 80(13) of the Act in respect of a commercial obligation that is settled, the amount that would be determined under that subsection in respect of the obligation, if the value of E in the formula in that subsection were 1, is deemed to be a capital gain of the taxpayer from a disposition of property on the day on which the settlement occurs,

(*k*) the taxpayer's capital gains and losses from dispositions of property (other than taxable Canadian property) while the taxpayer is a non-resident are deemed to be nil,

(*l*) where an election is made by a taxpayer under paragraph 104(21.4)(*d*) of the Act, as enacted by subsection 48(3), subsection 130.1(4.3) of the Act, as enacted by subsection 76(3), or subsection 131(1.6) of the Act, as enacted by subsection 77(2), for a year, the portion of the taxpayer's net gains for the year that are to be treated as being in respect of capital gains realized on dispositions of property that occurred in a particular period in the year is that proportion of those net gains that the number of days in the particular period is of the number of days in the year,

(*m*) where the election made under paragraph 104(21.4)(*d*) of the Act, as enacted by subsection 48(3), for the year was made by a personal trust, the portion of the taxpayer's net gains for the year that are to be treated as being in respect of capital gains realized on dispositions of property that occurred in a particular period in the year is that proportion of those net gains that the number of days in the particular period is of the number of days that are in all periods in the year in which a net gain was realized,

(*n*) where in the course of administering the estate of a deceased taxpayer, a capital loss from a disposition of property by the legal representative of a deceased taxpayer is deemed under paragraph 164(6)(*c*) of the Act to be a capital loss of the deceased taxpayer from the disposition of property by the taxpayer in the taxpayer's last taxation year and not to be a capital loss of the estate, the

capital loss is deemed to be from the disposition of a property by the taxpayer immediately before the taxpayer's death,

(*o*) each capital gain referred to in paragraph 104(21.4)(*a*) of the Act, as enacted by subsection 48(3), in respect of a beneficiary, shall be determined as if that paragraph were read without reference to subparagraph 104(21.4)(*a*)(ii),

(*p*) where no capital gains or losses are realized in the period, the amount of net capital gains or losses for that period is deemed to be nil,

(*q*) where a net amount is included as a capital gain of a taxpayer for a taxation year because of the granting of an option under subsection 49(1) of the Act, the net amount is deemed to be a capital gain of the taxpayer from a disposition of property on the day on which the option was granted,

(*r*) where a net amount is included as a capital gain of a corporation for its taxation year under subsection 49(2) of the Act because of the expiration of an option that was granted by the corporation, the net amount is deemed to be a capital gain of the corporation from a disposition of property on the day on which the option expired,

(*s*) where a net amount is included as a capital gain of a trust for its taxation year under subsection 49(2.1) of the Act because of the expiration of an option that was granted by the trust, the net amount is deemed to be a capital gain of the trust from a disposition of property on the day on which the option expired, and

(*t*) where a net amount is included as a capital gain of a taxpayer for a taxation year because of subsection 49(3), (3.01) or (3.1) of the Act, the net amount is deemed to be a capital gain of the taxpayer from a disposition of property on the day on which the option was exercised.

(6) Subsection (2) applies to the 2000 and subsequent taxation years except that,

(*a*) for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/4" in paragraph 38(*a*.1) of the Act, as enacted by subsection (2), shall be read as a reference to 1/2 of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection (1), that applies to the taxpayer for the year; and

(*b*) for a taxation year that ended before February 28, 2000, the reference to the fraction "1/4" in paragraph 38(*a*.1) of the Act, as enacted by subsection (2), shall be read as a reference to the fraction "3/8".

(7) Subsection (3) applies to gifts made by a taxpayer after February 27, 2000 except that,

(*a*) if the taxpayer's taxation year began after February 28, 2000 and ended before October 17, 2000, the reference to the fraction "1/4" in paragraph 38(*a*.2) of the Act, as enacted by subsection (3), shall be read as a reference to the fraction "1/3"; and

(*b*) if the taxpayer's taxation year includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/4" in paragraph 38(*a*.2) of the Act, as enacted by subsection (3), shall be read as a reference to 1/2 of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection (1), that applies to the taxpayer for the year.

14. (1) Subparagraphs 39(9)(*b*)(i) to (i.2) of the Act are replaced by the following:

(i) the total of all amounts each of which is twice the amount deducted by the taxpayer under section 110.6 in computing the taxpayer's taxable income for a preceding taxation year that

(A) ended before 1988, or

(B) begins after October 17, 2000,

(i.1) the total of all amounts each of which is

(A) 3/2 of the amount deducted under section 110.6 in computing the taxpayer's taxable income for a preceding taxation year that

(I) ended after 1987 and before 1990, or

(II) began after February 27, 2000 and ended before October 18, 2000, or

(B) the amount determined by multiplying the reciprocal of the fraction in paragraph 38(*a*) that applies to the taxpayer for each of the taxpayer's taxation years that includes either February 28, 2000 or October 18, 2000 by the amount deducted under section 110.6 in computing the taxpayer's taxable income for that year, and

(i.2) the total of all amounts each of which is 4/3 of the amount deducted under section 110.6 in computing the taxpayer's taxable income for a preceding taxation year that ended after 1989 and before February 28, 2000

(2) Subparagraphs 39(10)(*b*)(i) to (i.2) of the Act are replaced by the following:

(i) the total of all amounts each of which is twice the amount designated by the trust under subsection 104(21.2) in respect of a beneficiary in its return of income for a preceding taxation year that

(A) ended before 1988, or

(B) begins after October 17, 2000,

(i.1) the total of all amounts each of which is

(A) 3/2 of the amount designated by the trust under subsection 104(21.2) in respect of a beneficiary in its return of income for a preceding taxation year that

(I) ended after 1987 and before 1990, or

(II) began after February 27, 2000 and ended before October 18, 2000, or

(B) the amount determined by multiplying the reciprocal of the fraction in paragraph 38(*a*) that applies to the trust for each of the trust's taxation years that includes either February 28, 2000 or October 18, 2000 by the amount designated by the trust under subsection 104(21.2) in respect of a beneficiary in its return of income for that year, and

(i.2) the total of all amounts each of which is 4/3 of the amount designated by the trust under subsection 104(21.2) in respect of a beneficiary in its return of income for a preceding taxation year that ended after 1989 and before February 28, 2000

(3) Subsection 39(11) of the Act is replaced by the following:

Recovery of bad debt

(11) Where an amount is received in a taxation year on account of a debt (in this subsection referred to as the "recovered amount") in respect of which a deduction for bad debts had been made under subsection

20(4.2) in computing a taxpayer's income for a preceding taxation year, the amount, if any, by which 1/2 of the recovered amount exceeds the amount determined under paragraph 12(1)(*i*.1) in respect of the recovered amount is deemed to be a taxable capital gain of the taxpayer from a disposition of capital property in the year.

(4) Subsections (1) to (3) apply to taxation years that end after February 27, 2000 except that, for taxation years that ended after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" in subsection 39(11) of the Act, as enacted by subsection (3), shall be read as a reference to the fraction "2/3".

15. (1) Paragraphs (*a*) and (*b*) of the description of C in the definition "exempt capital gains balance" in subsection 39.1(1) of the Act are replaced by the following:

(*a*) if the entity is a trust described in any of paragraphs (*d*) and (*h*) to (*j*) of the definition "flow-through entity" in this subsection, the total of

(i) 3/2 of the total of all amounts each of which is the amount by which the individual's taxable capital gain (determined without reference to this section), for a preceding taxation year that began after February 27, 2000 and ended before October 18, 2000 that resulted from a designation made under subsection 104(21) by the trust, was reduced under subsection (3),

(ii) 4/3 of the total of all amounts each of which is the amount by which the individual's taxable capital gain (determined without reference to this section), for a preceding taxation year that ended before February 28, 2000 that resulted from a designation made under subsection 104(21) by the trust, was reduced under subsection (3),

(iii) the amount claimed by the individual under subparagraph 104(21.4)(*a*)(ii) for a preceding taxation year, and

(iv) twice the total of all amounts each of which is the amount by which the individual's taxable capital gain (determined without reference to this section) for a preceding taxation year that began after October 17, 2000 that resulted from a designation made under subsection 104(21) by the trust, was reduced under subsection (3),

(*b*) if the entity is a partnership, <u>the total of</u>

(i) <u>3/2 of the total of</u>

<u>(A)</u> the total of all amounts each of which is the amount by which the individual's share of the partnership's taxable capital gains <u>(determined without reference to this section)</u>, for its fiscal <u>periods</u> that <u>began after February 27, 2000 and ended before October 18, 2000</u>, was reduced under subsection (4), and

<u>(B)</u> the total of all amounts each of which is the amount by which the individual's share of the partnership's income from a business <u>(determined without reference to this section)</u>, for its fiscal <u>periods</u> that <u>began after February 27, 2000 and ended before October 18, 2000</u>, was reduced under subsection (5),

(ii) 4/3 of the total of

(A) the total of all amounts each of which is the amount by which the individual's share of the partnership's taxable capital gains (determined without reference to this section), for its fiscal periods that ended before February 28, 2000 and in a preceding taxation year was reduced under subsection (4), and

(B) the total of all amounts each of which is the amount by which the individual's share of the partnership's income from a business (determined without reference to this section), for its fiscal periods that ended before February 28, 2000 and in a preceding taxation year, was reduced under subsection (5),

(iii) the product obtained when the reciprocal of the fraction in paragraph 38(*a*) that applies to the partnership for its fiscal period that includes either February 28, 2000 or October 17, 2000 is multiplied by the total of

(A) the total of all amounts each of which is the amount by which the individual's share of the partnership's taxable capital gains (determined without reference to this section), for its fiscal period that includes either February 28, 2000 or October 17, 2000 and ended in a preceding taxation year, was reduced under subsection (4), and

(B) the total of all amounts each of which is the amount by which the individual's share of the partnership's income from a business (determined without reference to this section), for its fiscal period that includes either February 28, 2000 or

October 17, 2000 and ended in a preceding taxation year was reduced under subsection (5), and

(iv) twice the total of

(A) the total of all amounts each of which is the amount by which the individual's share of the partnership's taxable capital gains (determined without reference to this section), for its fiscal periods that began after October 17, 2000 and ended in a preceding taxation year, was reduced under subsection (4), and

(B) the total of all amounts each of which is the amount by which the individual's share of the partnership's income from a business (determined without reference to this section), for its fiscal periods that began after October 17, 2000 and ended in a preceding taxation year, was reduced under subsection (5), and

(2) Paragraphs (*a*) and (*b*) of the description of B in subsection 39.1(2) of the Act are amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(3) Subsection 39.1(3) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(4) The description of A in subsection 39.1(4) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(5) Paragraph 39.1(5)(*a*) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(6) Subsection (1) applies to taxation years that end after February 27, 2000.

(7) Subsections (2) to (5) apply to taxation years that end after February 27, 2000 except that, where the taxation year of an entity that ends in the taxpayer's taxation year includes either February 28, 2000 or October 17, 2000

(*a*) the reference to the word "twice" in paragraphs (*a*) and (*b*) of the description of B in subsection 39.1(2) of the Act, as enacted by subsection (2), shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to

the entity for its taxation year that ends in the taxpayer's taxation year, multiplied by";

(*b*) the reference in subsection 39.1(3) of the Act, as enacted by subsection (3), to the fraction "1/2" shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the entity for its taxation year that ends in the taxpayer's taxation year;

(*c*) the reference in the description of A in subsection 39.1(4) of the Act, as enacted by subsection (4), to the fraction "1/2" shall be read as reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the entity for its taxation year that ends in the taxpayer's taxation year; and

(*d*) the reference in paragraph 39.1(5)(*a*) of the Act, as enacted by subsection (5), to the fraction "1/2" shall be read as reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the entity for its taxation year that ends in the taxpayer's taxation year.

16. (1) Subsection 41(1) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, for taxation years that include either February 28, 2000 or October 17, 2000, the reference in subsection 41(1) of the Act, as enacted by subsection (1), to the fraction "1/2" shall be read as reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year.

17. (1) The Act is amended by adding the following after section 44:

Definitions

44.1 (1) The definitions in this subsection apply in this section.

"ACB reduction"
« réduction du prix de base rajusté »

"ACB reduction" of an individual in respect of a replacement share of the individual in respect of a qualifying disposition of the individual means the amount determined by the formula

$$D \times (E/F)$$

where

D is the permitted deferral of the individual in respect of the qualifying disposition;

E is the qualifying cost to the individual of the replacement share; and

F is the qualifying cost to the individual of all the replacement shares of the individual in respect of the qualifying disposition.

"active business corporation"
« société exploitant activement une entreprise »

"active business corporation" at any time means, subject to subsection (10), a corporation that is, at that time, a taxable Canadian corporation all or substantially all of the fair market value of the assets of which at that time is attributable to assets of the corporation that are

(*a*) assets used principally in an active business carried on by the corporation or by an active business corporation that is related to the corporation;

(*b*) shares issued by or debt owing by other active business corporations that are related to the corporation; or

(*c*) a combination of assets described in paragraphs (*a*) and (*b*).

"carrying value"
« valeur comptable »

"carrying value" of the assets of a corporation at any time means the amount at which the assets of the corporation would be valued for the purpose of the corporation's balance sheet as of that time if that balance sheet were prepared in accordance with generally accepted accounting principles used in Canada at that time, except that an asset of a corporation that is a share or debt issued by a related corporation is deemed to have a carrying value of nil.

"common share"
« action ordinaire »

"common share" means a share prescribed for the purpose of paragraph 110(1)(*d*).

"eligible pooling arrangement"
« arrangement admissible de mise en commun »

"eligible pooling arrangement" in respect of an individual means an agreement in writing made between the individual and another person or partnership (which other person or partnership is referred to in this definition and subsection (3) as the "investment manager") where the agreement provides for

(*a*) the transfer of funds or other property by the individual to the investment manager for the purpose of making investments on behalf of the individual;

(*b*) the purchase of eligible small business corporation shares with those funds, or the proceeds of a disposition of the other property, within 60 days after receipt of those funds or the other property by the investment manager; and

(*c*) the provision of a statement of account to the individual by the investment manager at the end of each month that ends after the transfer disclosing the details of the investment portfolio held by the investment manager on behalf of the individual at the end of that month and the details of the transactions made by the investment manager on behalf of the individual during the month.

"eligible small business corporation"
« société admissible exploitant une petite entreprise »

"eligible small business corporation" at any time means, subject to subsection (10), a corporation that, at that time, is a Canadian-controlled private corporation all or substantially all of the fair market value of the assets of which at that time is attributable to assets of the corporation that are

(*a*) assets used principally in an active business carried on primarily in Canada by the corporation or by an eligible small business corporation that is related to the corporation;

(*b*) shares issued by or debt owing by other eligible small business corporations that are related to the corporation; or

(*c*) a combination of assets described in paragraphs (*a*) and (*b*).

"eligible small business corporation share"
« action déterminée de petite entreprise »

"eligible small business corporation share" of an individual means a common share issued by a corporation to the individual if

(*a*) at the time the share was issued, the corporation was an eligible small business corporation; and

(*b*) immediately before and after the share was issued, the total carrying value of the assets of the corporation and corporations related to it did not exceed $50,000,000.

"permitted deferral"
« montant de report autorisé »

"permitted deferral" of an individual in respect of a qualifying disposition of the individual means the amount determined by the formula

$$(G/H) \times I$$

where

G is the lesser of the amount included in the description of H and the total of all amounts each of which is the qualifying cost to the individual of a replacement share in respect of the qualifying disposition;

H is the qualifying portion of the individual's proceeds of disposition from the qualifying disposition; and

I is the qualifying portion of the individual's capital gain from the qualifying disposition.

"qualifying cost"
« coût admissible »

"qualifying cost" to an individual of particular replacement shares of the individual in respect of a qualifying disposition of the individual that are shares of the capital stock of a particular eligible small business corporation means the lesser of

(*a*) the total of all amounts each of which is the cost to the individual of such a replacement share; and

(*b*) the amount by which $2,000,000 exceeds the total of all amounts each of which is the cost to the individual of a share that was a share of the capital stock of the particular eligible small business corporation or of a corporation related to it at the time the particular replacement shares were acquired and that was a replacement share of the individual in respect of another qualifying disposition.

"qualifying disposition"
« disposition admissible »

"qualifying disposition" of an individual (other than a trust) means, subject to subsection (9), a disposition of shares of the capital stock of a corporation where each such share disposed of was,

(*a*) an eligible small business corporation share of the individual;

(*b*) throughout the period during which the individual owned the share, a common share of an active business corporation; and

(*c*) throughout the 185-day period that ended immediately before the disposition of the share, owned by the individual.

"qualifying portion of a capital gain"
« partie admissible d'un gain en capital »

"qualifying portion of a capital gain" of an individual from a particular qualifying disposition of the individual means the amount determined by the formula

$$J \times (1 - (K/L))$$

where

J is the individual's capital gain from the particular qualifying disposition, determined without reference to this section;

K is the amount, if any, by which the total of

(*a*) the total of all amounts each of which is the adjusted cost base to the individual of a share of the particular corporation that was the subject of the particular qualifying disposition (which adjusted cost base shall be determined immediately before the share was disposed of and without reference to this section), and

(*b*) the total of all amounts each of which is the adjusted cost base to the individual of a share of the particular corporation or a corporation related to it at the time of the particular qualifying disposition that was the subject of another qualifying disposition (in respect of which a permitted deferral was deducted under this section by the individual) that occurred at or before the time of the particular qualifying disposition (which adjusted cost base shall be determined immediately before the share was disposed of and without reference to this section)

exceeds

(*c*) $ 2,000,000; and

L is the total of all amounts each of which is the adjusted cost base to the individual of a share of the particular corporation that was the subject of the particular qualifying disposition (which adjusted cost base shall be determined immediately before the share was disposed of and without reference to this section).

"qualifying portion of the proceeds of disposition"
« partie admissible du produit de disposition »

"qualifying portion of the proceeds of disposition" of an individual from a qualifying disposition means the amount determined by the formula

$$M \times (N/O)$$

where

M is the individual's proceeds of disposition from the qualifying disposition;

N is the individual's qualifying portion of the capital gain from the qualifying disposition; and

O is the individual's capital gain from the qualifying disposition, determined without reference to this section.

"replacement share"
« action de remplacement »

"replacement share" of an individual in respect of a qualifying disposition of the individual in a taxation year means an eligible small business corporation share, of the individual, that is

(*a*) acquired by the individual in the year or within 60 days after the end of the year, but not later than 120 days after the qualifying disposition occurred; and

(*b*) designated by the individual, in the individual's return of income for the year, to be a replacement share in respect of the qualifying disposition.

Capital gain deferral

(2) Where an individual has made a qualifying disposition in a taxation year,

(*a*) the individual's capital gain for the year from the qualifying disposition is deemed to be the amount by which the individual's capital gain for the year from the qualifying disposition, determined without reference to this section, exceeds the individual's permitted deferral in respect of the qualifying disposition;

(*b*) in computing the adjusted cost base to the individual of a replacement share of the individual in respect of the qualifying disposition at any time after its acquisition, there shall be deducted the amount of the ACB reduction of the individual in respect of the replacement share; and

(*c*) where the qualifying disposition was a disposition of a share that was a taxable Canadian property of the individual, the replacement share of the individual in respect of the qualifying disposition is deemed to be taxable Canadian property of the individual.

Special rule – re: eligible pooling arrangements

(3) Except for the purpose of the definition "eligible pooling arrangement" in this section, any transaction entered into by an investment manager under an eligible pooling arrangement on behalf of an individual is deemed to be a transaction of the individual and not a transaction of the investment manager.

Special rule – re: acquisitions on death

(4) For the purpose of this section, a share of the capital stock of a corporation, acquired by an individual as a consequence of the death of a person who is the individual's spouse, common-law partner or parent, is deemed to be a share that was acquired by the individual at the time it was acquired by that person and owned by the individual throughout the period that it was owned by that person, if

(*a*) where the person was the spouse or common-law partner of the individual, the share was an eligible small business share of the person and subsection 70(6) applied to the individual in respect of the share; or

(*b*) where the person was the individual's parent, the share was an eligible small business share of the parent and subsection 70(9.2) applied to the individual in respect of the share.

Special rule – re: breakdown of relationships

(5) For the purpose of this section, a share of the capital stock of a corporation, acquired by an individual from a person who was the individual's former spouse or common-law partner as a consequence of the settlement of rights arising out of their marriage or common-law partnership, is deemed to be a share that was acquired by the individual at the time it was acquired by that person and owned by the individual throughout the period that it was owned by that person if the share was an eligible small business share of the person and subsection 73(1) applied to the individual in respect of the share.

Special rule – re: eligible small business corporation share exchanges

(6) For the purpose of this section, where an individual receives shares of the capital stock of a corporation that are eligible small business corporation shares of the individual (in this subsection referred to as the "new shares") as the sole consideration for the disposition of shares issued by another corporation that were eligible small business corporation shares of the individual (in this subsection referred to as the "exchanged shares"), the new shares are deemed to have been owned by the individual throughout the period that the exchanged shares were owned by the individual if

(*a*) paragraph 85(1)(*g*) or subsection 85.1(3) or 87(4) applied to the individual in respect of the new shares; and

(*b*) the individual's total proceeds of disposition of the exchanged shares was equal to the total of all amounts each of which was the individual's adjusted cost base of an exchanged share immediately before the disposition.

Special rule – re: active business corporation share exchanges

(7) For the purpose of this section, where an individual receives common shares of the capital stock of a corporation (in this subsection referred to as the "new shares") as the sole consideration for the disposition of common shares of another corporation (in this subsection referred to as the "exchanged shares"), the new shares are deemed to be

eligible small business corporation shares of the individual and shares of the capital stock of an active business corporation that were owned by the individual throughout the period that the exchanged shares were owned by the individual, if

(*a*) paragraph 85(1)(*g*) or subsection 85.1(3) or 87(4) applied to the individual in respect of the new shares;

(*b*) the total of the individual's proceeds of disposition in respect of the disposition of the exchanged shares was equal to the total of the individual's adjusted cost bases immediately before the disposition of such shares; and

(*c*) the disposition of the exchanged shares was a qualifying disposition of the individual.

Special rule – re: carrying on an active business

(8) For the purpose of the definitions in subsection (1), a property held at any particular time by a corporation that would, if this Act were read without reference to this subsection, be considered to carry on an active business at that time, is deemed to be used or held by the corporation in the course of carrying on that active business if the property (or other property for which the property is substituted property) was acquired by the corporation, at any time in the 36 month period ending at the particular time, because the corporation

(*a*) issued a debt or a share of a class of its capital stock in order to acquire money for the purpose of acquiring property to be used in or held in the course of, or making expenditures for the purpose of, earning income from an active business carried on by it;

(*b*) disposed of property used or held by it in the course of carrying on an active business in order to acquire money for the purpose of acquiring property to be used in or held in the course of, or making expenditures for the purpose of, earning income from an active business carried on by it; or

(*c*) accumulated income derived from an active business carried on by it in order to acquire property to be used in or held in the course of, or to make expenditures for the purpose of, earning income from an active business carried on by it.

Special rule – re: qualifying disposition

(9) A disposition of a common share of an active business corporation (in this subsection referred to as the "subject share") by an individual that, but for this subsection, would be a qualifying disposition of the individual is deemed not to be a qualifying disposition of the individual unless the active business of the corporation referred to in paragraph (*a*) of the definition "active business corporation" in subsection (1) was carried on primarily in Canada

(*a*) at all times in the period that began at the time the individual last acquired the subject share and ended at the time of disposition, if that period is less than 730 days; or

(*b*) in any other case, for at least 730 days in the period referred to in paragraph (*a*).

Special rule – re: exceptions

(10) For the purpose of this section, an eligible small business corporation and an active business corporation at any time does not include a corporation that is at that time,

(*a*) a professional corporation;

(*b*) a specified financial institution;

(*c*) a corporation the principal business of which is the leasing, rental, development or sale, or any combination of those activities, of real property owned by it; or

(*d*) a corporation more than 50 per cent of the fair market value of the property of which (net of debts incurred to acquire the property) is attributable to real property.

Determination rule

(11) In determining whether a share owned by an individual is an eligible small business corporation share of the individual, this Act shall be read without reference to section 48.1.

Anti-avoidance rule

(12) The permitted deferral of an individual in respect of a qualifying disposition of shares issued by a corporation (in this subsection referred to as "new shares") is deemed to be nil where

(*a*) the new shares (or shares for which the new shares are substituted property) were issued to the individual or a person related to the individual as part of a series of transactions or events in which

(i) shares of the capital stock of a corporation (in this subsection referred to as the "old shares") were disposed of by the individual or a person related to the individual, or

(ii) the paid-up capital of old shares or the adjusted cost base to the individual or to a person related to the individual of the old shares was reduced;

(*b*) the new shares (or shares for which the new shares are substituted property) were issued by the corporation that issued the old shares or were issued by a corporation that, at or immediately after the time of issue of those shares, was a corporation that was not dealing at arm's length with the corporation that issued the old shares; and

(*c*) it is reasonable to conclude that one of the main reasons for the series of transactions or events or a transaction in the series was to permit the individual, persons related to the individual, or the individual and persons related to the individual to become eligible to deduct under subsection (2) permitted deferrals in respect of qualifying dispositions of new shares (or shares substituted for the new shares) the total of which would exceed the total that those persons would have been eligible to deduct under subsection (2) in respect of permitted deferrals in respect of qualifying dispositions of old shares.

(2) Subsection (1) applies to dispositions that occur after February 27, 2000 except that, for dispositions that occurred after February 27, 2000 and before October 18, 2000,

(*a*) the definition "active business corporation" in subsection 44.1(1) of the Act, as enacted by subsection (1), shall be read without reference to the words "subject to subsection (10)" and as if the reference to the words "carried on" in paragraph (*a*) of that definition were read as a reference to "carried on primarily in Canada";

(*b*) the definition "eligible small business corporation" in subsection 44.1(1) of the Act, as enacted by subsection (1), shall be read without reference to the words "subject to subsection (10)";

(*c*) the definition "eligible small business corporation share" in subsection 44.1(1) of the Act, as enacted by subsection (1), shall be read as follows:

""eligible small business corporation share" of an individual means a common share issued by a corporation to the individual if

(*a*) at the time the share was issued, the corporation was an eligible small business corporation;

(*b*) immediately before the share was issued, the total carrying value of the assets of the corporation and corporations related to it did not exceed $2,500,000; and

(*c*) immediately after the share was issued, the total carrying value of the assets of the corporation and corporations related to it did not exceed $10,000,000.";

(*d*) the definition "qualifying cost" in subsection 44.1(1) of the Act, as enacted by subsection (1), shall be read as if the reference to "$2,000,000" in paragraph (*b*) of that definition were read as a reference to "$500,000";

(*e*) the definition "qualifying disposition" in subsection 44.1(1) of the Act, as enacted by subsection (1), shall be read without reference to the words "subject to subsection (9)";

(*f*) the definition "qualifying portion of a capital gain" in subsection 44.1(1) of the Act, as enacted by subsection (1), shall be read as if the reference to "$2,000,000" in paragraph (*c*) of the description of K in that definition were read as a reference to "$500,000"; and

(*g*) section 44.1 of the Act, as enacted by subsection (1), shall be read without reference to subsections 44.1(9) and (10).

18. (1) The portion of subsection 46(1) of the Act before paragraph (*a*) is replaced by the following:

Personal-use property

46. (1) Where a taxpayer has disposed of a personal-use property (other than an excluded property disposed of in circumstances to which subsection 110.1(1), or the definition "total charitable gifts", "total cultural gifts" or "total ecological gifts" in subsection 118.1(1), applies) of the taxpayer, for the purposes of this subdivision

(2) The portion of subsection 46(2) of the Act before paragraph (*a*) is replaced by the following:

Where part only of property disposed of

(2) Where a taxpayer has disposed of part of a personal-use property (other than a part of an excluded property disposed of in circumstances to which subsection 110.1(1), or the definition "total charitable gifts", "total cultural gifts" or "total ecological gifts" in subsection 118.1(1), applies) owned by the taxpayer and has retained another part of the property, for the purposes of this subdivision

(3) Section 46 of the Act is amended by adding the following after subsection (4):

Excluded property

(5) For the purpose of this section, "excluded property" of a taxpayer means property acquired by the taxpayer, or by a person with whom the taxpayer does not deal at arm's length, in circumstances in which it is reasonable to conclude that the acquisition of the property relates to an arrangement, plan or scheme that is promoted by another person or partnership and under which it is reasonable to conclude that the property will be the subject of a gift to which subsection 110.1(1), or the definition "total charitable gifts", "total cultural gifts" or "total ecological gifts" in subsection 118.1(1), applies.

(4) Subsections (1) to (3) apply to property acquired after February 27, 2000.

19. (1) Section 47 of the Act is amended by adding the following after subsection (2):

Securities acquired by employee

(3) For the purpose of subsection (1), a security (within the meaning assigned by subsection 7(7)) acquired by a taxpayer after February 27, 2000 is deemed not to be identical to any other security acquired by the taxpayer if

(*a*) the security is acquired in circumstances to which any of subsections 7(1.1), (1.5) or (8) or 147(10.1) applies; or

(*b*) the security is a security to which subsection 7(1.31) applies.

(2) Subsection (1) applies after 1999.

20. (1) Clauses 53(1)(*e*)(i)(A) and (A.1) of the Act are replaced by the following:

(A) the fractions set out in subsection 14(5), paragraphs 38(*a*) to (*a*.2), subsection 41(1) and in the formula in paragraph 14(1)(*b*),

(A.1) paragraph 18(1)(*l*.1),

(A.2) the description of C in the formula in paragraph 14(1)(*b*), and

(2) Paragraph 53(1)(*j*) of the Act is replaced by the following:

Share or fund unit taxed as stock option benefit

(*j*) if the property is a security (within the meaning assigned by subsection 7(7)) and, in respect of its acquisition by the taxpayer, a benefit was deemed by section 7 to have been received in any taxation year that ends after 1971 and begins before that time by the taxpayer or by a person that did not deal at arm's length with the taxpayer or, if the security was acquired after February 27, 2000, would have been so deemed if section 7 were read without reference to subsections 7(1.1) and (8), the amount of the benefit that was, or would have been, so deemed to have been received;

(3) Subparagraph (ii) of the description of A in paragraph 53(1)(*r*) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(4) Paragraph 53(2)(*a*) of the Act is amended by striking out the word "and" at the end of subparagraph (iii), by adding the word "and" at the end of subparagraph (iv) and by adding the following after subparagraph (iv):

(v) any amount required by paragraph 44.1(2)(*b*) to be deducted in computing the adjusted cost base to the taxpayer of the share;

(5) Clauses 53(2)(*c*)(i)(A) and (A.1) of the Act are replaced by the following:

(A) the fractions set out in subsection 14(5), paragraph 38(*b*) and in the formula in paragraph 14(1)(*b*),

(A.1) paragraph 18(1)(*l*.1),

(A.2) the description of C in the formula in paragraph 14(1)(*b*),

(6) Clause 53(2)(*c*)(ii)(B) of the Act is replaced by the following:

(B) the Canadian exploration and development expenses and foreign resource pool expenses, if any, incurred by the partnership in the fiscal period,

(7) Subclause 53(2)(*h*)(i.1)(B)(I) of the Act is amended by replacing the reference to the fraction "1/3" with a reference to the fraction "1/2".

(8) Subsections (1) and (5) apply in respect of fiscal periods that end after February 27, 2000 and, for fiscal periods that ended after February 18, 1997 and before February 28, 2000, clause 53(1)(*e*)(i)(A) of the Act, as enacted by subsection (1), shall be read as follows:

"(A) the fractions set out in subsection 14(5), paragraphs 38(*a*) and (*a*.1) and subsection 41(1),"

(9) Subsection (2) applies after 1999.

(10) Subsection (3) applies to taxation years that end after February 27, 2000 except that, in applying paragraph 53(1)(*r*) of the Act, as enacted by subsection (3), for those years in respect of a taxpayer's interest in an entity, where a taxation year of the entity that includes either February 28, 2000 or October 17, 2000 ends in the taxpayer's taxation year, the reference to the word "twice" in subparagraph (ii) of the description of A in that paragraph shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted

by subsection 13(1), that applies in respect of the entity for its taxation year, multiplied by".

(11) Subsection (4) applies to dispositions that occur after February 27, 2000.

(12) Subsection (6) applies to taxation years that begin after 2000.

(13) Subsection (7) applies to taxation years that end after February 27, 2000 except that, in applying subclause 53(2)(*h*)(i.1)(B)(I) of the Act, as enacted by subsection (7), for those years in respect of a taxpayer's interest in a trust, where a taxation year of the trust that includes either February 28, 2000 or October 17, 2000 ends in the taxpayer's taxation year, the reference to the fraction "1/2" in that subclause shall be read as a reference to the expression "the fraction that is equal to the fraction obtained when 1 is subtracted from the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the trust for its taxation year, multiplied by".

21. (1) Paragraph 55(5)(*b*) of the Act is amended by striking out the word "and" at the end of subparagraph (ii) and by replacing subparagraph (iii) with the following:

(iii) the total of all amounts each of which is an amount required to have been included under this subparagraph as it read in its application to a taxation year that ended before February 28, 2000, and

(iv) the amount, if any, by which

(A) 1/2 of the total of all amounts each of which is an amount required by paragraph 14(1)(*b*) to be included in computing the corporation's income in respect of a business carried on by the corporation for a taxation year that is included in the period and that ended after February 27, 2000 and before October 18, 2000,

exceeds

(B) where the corporation has deducted an amount under subsection 20(4.2) in respect of a debt established by it to have become a bad debt in a taxation year that is included in the period and that ended after February 27, 2000 and before October 18, 2000, or has an allowable capital loss for such a year because of the application of subsection 20(4.3), the amount determined by the formula

$$V + W$$

where

V is 1/2 of the value determined for A under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

W is 1/3 of the value determined for B under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

(C) in any other case, nil; and

(v) the amount, if any, by which

(A) the total of all amounts each of which is an amount required by paragraph 14(1)(*b*) to be included in computing the corporation's income in respect of a business carried on by the corporation for a taxation year that is included in the period and that ends after October 17, 2000,

exceeds

(B) where the corporation has deducted an amount under subsection 20(4.2) in respect of a debt established by it to have become a bad debt in a taxation year that is included in the period and that ends after October 17, 2000, or has an allowable capital loss for such a year because of the application of subsection 20(4.3), the amount determined by the formula

$$X + Y$$

where

X is the value determined for A under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

Y is 1/3 of the value determined for B under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

(C) in any other case, nil;

(2) Subsection (1) applies in respect of taxation years that end after February 27, 2000.

22. (1) The portion of paragraph 56(1)(*n*) of the Act after subparagraph (i) is replaced by the following:

exceeds

(ii) the taxpayer's scholarship exemption for the year computed under subsection (3);

(2) Section 56 of the Act is amended by adding the following after subsection (2):

Exemption for scholarships, fellowships, bursaries and prizes

(3) For the purpose of subparagraph (1)(*n*)(ii), a taxpayer's scholarship exemption for a taxation year is the greatest of

(*a*) $500,

(*b*) the lesser of

(i) $3,000 and

(ii) the total of all amounts each of which is the amount included under subparagraph (1)(*n*)(i) in computing the taxpayer's income for the year in respect of a scholarship, fellowship or bursary received in connection with the taxpayer's enrolment in an educational program in respect of which an amount may be deducted under subsection 118.6(2) in computing the taxpayer's tax payable under this Part for the year, and

(*c*) the total of all amounts each of which is the lesser of

(i) the amount included under subparagraph (1)(*n*)(i) in computing the taxpayer's income for the year in respect of a scholarship, fellowship, bursary or prize that is to be used by the taxpayer in the production of a literary, dramatic, musical or artistic work, and

(ii) the total of all amounts each of which is an expense incurred by the taxpayer in the year for the purpose of fulfilling the conditions under which the amount described in subparagraph (i) was received, other than

(A) personal or living expenses of the taxpayer (except expenses in respect of travel, meals and lodging incurred by

the taxpayer in the course of fulfilling those conditions and while absent from the taxpayer's usual place of residence for the period to which the scholarship, fellowship, bursary or prize, as the case may be, relates),

(B) expenses for which the taxpayer is entitled to be reimbursed, and

(C) expenses that are otherwise deductible in computing the taxpayer's income.

(3) Subsections (1) and (2) apply to the 2000 and subsequent taxation years.

23. (1) Subsection 59(1) of the Act is replaced by the following:

Consideration for foreign resource property

59. (1) Where a taxpayer has disposed of a foreign resource property, there shall be included in computing the taxpayer's income for a taxation year the amount, if any, by which

(*a*) the portion of the taxpayer's proceeds of disposition from the disposition of the property that becomes receivable in the year

exceeds

(*b*) the total of

(i) all amounts each of which is an outlay or expense made or incurred by the taxpayer for the purpose of making the disposition that was not otherwise deductible for the purposes of this Part, and

(ii) where the property is a foreign resource property in respect of a country, the amount designated under this subparagraph in prescribed form filed with the taxpayer's return of income for the year in respect of the disposition.

Partnerships

(1.1) Where a taxpayer is a member of a partnership in a fiscal period of the partnership, the taxpayer's share of the amount that would be included under subsection (1) in respect of a disposition of a foreign resource property in computing the partnership's income for a taxation year if the partnership were a person, the fiscal period were a taxation year, subsection (1) were read without reference to subparagraph

(1)(*b*)(ii) and section 96 were read without reference to paragraph 96(1)(*d*) is deemed to be proceeds of disposition that become receivable by the taxpayer at the end of the fiscal period in respect of a disposition of the property by the taxpayer.

(2) Subsection 59(3.2) of the Act is amended by adding the following after paragraph (*c*):

(*c*.1) any amount referred to in subsection 66.21(3);

(3) Subsection 59(1) of the Act, as enacted by subsection (1), and subsection (2) apply to taxation years that begin after 2000.

(4) Subsection 59(1.1) of the Act, as enacted by subsection (1), applies to fiscal periods that begin after 2000.

24. (1) Section 60 of the Act is amended by adding the following after paragraph (*d*):

CPP/QPP contributions on self-employed earnings

(*e*) 1/2 of the lesser of

(i) the total of all amounts each of which is an amount payable by the taxpayer in respect of self-employed earnings for the year as a contribution under the *Canada Pension Plan* or under a provincial pension plan within the meaning assigned by section 3 of that Act, and

(ii) the maximum amount of such contributions payable by the taxpayer for the year under the plan;

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

25. (1) Paragraph 63(1)(*a*) of the Act is replaced by the following:

(*a*) by the taxpayer, where the taxpayer is described in subsection (2) and the supporting person of the child for the year is a person described in <u>clause (i)(D) of the description of C in the formula in that subsection</u>, or

(2) Subparagraph 63(1)(*e*)(ii) of the Act is replaced by the following:

(ii) the total of all amounts each of which is the annual child care expense amount in respect of an eligible child of the taxpayer for the year

(3) The formula in paragraph 63(2)(*b*) of the Act is replaced by the following:

$$\underline{A \times C}$$

(4) The descriptions of A and B in paragraph 63(2)(*b*) of the Act are replaced by the following:

A is the total of all amounts each of which is the periodic child care expense amount in respect of an eligible child of the taxpayer for the year, and

(5) The formula in paragraph 63(2.3)(*c*) of the Act is replaced by the following:

$$\underline{A \times C}$$

(6) The descriptions of A and B in paragraph 63(2.3)(*c*) of the Act are replaced by the following:

A is the total of all amounts each of which is the periodic child care expense amount in respect of an eligible child of the taxpayer for the year, and

(7) Paragraph (*c*) of the definition "child care expense" in subsection 63(3) of the Act is replaced by the following:

(*c*) any such expenses paid in the year for a child's attendance at a boarding school or camp to the extent that the total of those expenses exceeds the product obtained when the periodic child care expense amount in respect of the child for the year is multiplied by the number of weeks in the year during which the child attended the school or camp, and

(8) Subsection 63(3) of the Act is amended by adding the following in alphabetical order:

"annual child care expense amount"
« montant annuel de frais de garde d'enfants »

"annual child care expense amount" in respect of an eligible child of a taxpayer for a taxation year means

(*a*) $10,000, where the child is a person in respect of whom an amount may be deducted under section 118.3 in computing a taxpayer's tax payable under this Part for the year, and

(*b*) where the child is not a person referred to in paragraph (*a*),

(i) $7,000, where the child is under 7 years of age at the end of the year, and

(ii) $4,000, in any other case;

"periodic child care expense amount"
« montant périodique de frais de garde d'enfants »

"periodic child care expense amount" in respect of an eligible child of a taxpayer for a taxation year means 1/40 of the annual child care expense amount in respect of the child for the year;

(9) Subsection (1) applies to the 1998 and subsequent taxation years.

(10) Subsections (2) to (8) apply to the 2000 and subsequent taxation years.

26. (1) Subparagraph (i) of the description of A in paragraph 64(*a*) of the Act is amended by striking out the word "or" at the end of clause (B) and by adding the following after clause (B):

(C) attend a designated educational institution or a secondary school at which the taxpayer is enrolled in an educational program, or

(2) Paragraph 64(*b*) of the Act is replaced by the following:

(*b*) 2/3 of the total of

(i) the total of all amounts each of which is

(A) an amount included under section 5, 6 or 7 or paragraph 56(1)(*n*), (*o*) or (*r*) in computing the taxpayer's income for the year, or

(B) the taxpayer's income for the year from a business carried on either alone or as a partner actively engaged in the business, and

(ii) where the taxpayer is in attendance at a designated educational institution or a secondary school at which the taxpayer is enrolled in an educational program, the least of

(A) $15,000,

(B) $375 times the number of weeks in the year during which the taxpayer is in attendance at the institution or school, and

(C) the amount, if any, by which the amount that would, if this Act were read without reference to this section, be the taxpayer's income for the year exceeds the total determined under subparagraph (i) in respect of the taxpayer for the year.

(3) Subsections (1) and (2) apply to the 2000 and subsequent taxation years.

27. (1) Subparagraph 66(4)(*a*)(i) of the Act is replaced by the following:

(i) the total of the foreign exploration and development expenses incurred by the taxpayer

(A) before the end of the year,

(B) at a time at which the taxpayer was resident in Canada, and

(C) where the taxpayer became resident in Canada before the end of the year, after the last time (before the end of the year) that the taxpayer became resident in Canada,

(2) The portion of paragraph 66(4)(*b*) of the Act before subparagraph (ii) is replaced by the following:

(*b*) of that total, the greater of

(i) the amount, if any, claimed by the taxpayer not exceeding 10% of the amount determined under paragraph (*a*) in respect of the taxpayer for the year, and

(3) Subparagraph 66(4)(*b*)(ii) of the Act is replaced by the following:

(ii) the total of

(A) the part of the taxpayer's income for the year, determined without reference to this subsection and subsection 66.21(4), that can reasonably be regarded as attributable to

(I) the production of petroleum or natural gas from natural accumulations outside Canada or from oil or gas wells outside Canada, or

(II) the production of minerals from mines outside Canada,

(B) the taxpayer's income for the year from royalties in respect of a natural accumulation of petroleum or natural gas outside Canada, an oil or gas well outside Canada or a mine outside Canada, determined without reference to this subsection and subsection 66.21(4), and

(C) all amounts each of which is an amount, in respect of a foreign resource property that has been disposed of by the taxpayer, equal to the amount, if any, by which

(I) the amount included in computing the taxpayer's income for the year by reason of subsection 59(1) in respect of the disposition

exceeds

(II) the total of all amounts each of which is that portion of an amount deducted under subsection 66.7(2) in computing the taxpayer's income for the year that

1. can reasonably be considered to be in respect of the foreign resource property, and

2. cannot reasonably be considered to have reduced the amount otherwise determined under clause (A) or (B) in respect of the taxpayer for the year.

(4) Section 66 of the Act is amended by adding the following after subsection (4):

Country-by-country FEDE allocations

(4.1) For greater certainty, the portion of an amount deducted under subsection (4) in computing a taxpayer's income for a taxation year that can reasonably be considered to be in respect of specified foreign exploration and development expenses of the taxpayer in respect of a country is considered to apply to a source in that country.

Method of allocation

(4.2) For the purpose of subsection (4.1), where a taxpayer has incurred specified foreign exploration and development expenses in respect of two or more countries, an allocation to each of those countries for a taxation year shall be determined in a manner that is

(*a*) reasonable having regard to all the circumstances, including the level and timing of

(i) the taxpayer's specified foreign exploration and development expenses in respect of the country, and

(ii) the profits or gains to which those expenses relate; and

(*b*) not inconsistent with the allocation made under subsection (4.1) for the preceding taxation year.

FEDE deductions where change of individual's residence

(4.3) Where at any time in a taxation year an individual becomes or ceases to be resident in Canada,

(*a*) subsection (4) applies to the individual as if the year were the period or periods in the year throughout which the individual was resident in Canada; and

(*b*) for the purpose of applying subsection (4), subsection (13.1) does not apply to the individual for the year.

(5) Subsection 66(5) of the Act is replaced by the following:

Dealers

(5) Subsections (3) and (4) and sections 59, 64, 66.1, 66.2, 66.21, 66.4 and 66.7 do not apply in computing the income for a taxation year of a taxpayer (other than a principal-business corporation) whose business includes trading or dealing in rights, licences or privileges to explore for, drill for or take minerals, petroleum, natural gas or other related hydrocarbons.

(6) The portion of subsection 66(11.4) of the Act after paragraph (*c*) is replaced by the following:

for the purposes of subsection (4) and sections 66.2, 66.21 and 66.4, except as those provisions apply for the purposes of section 66.7, the property is deemed not to have been acquired by the corporation or partnership before that time and is deemed to have been acquired by it at that time, except that, where the property has been disposed of by it before that time and not reacquired by it before that time, the property is deemed to have been acquired by the corporation or partnership immediately before it disposed of the property.

(7) The portion of subsection 66(12.4) of the Act before paragraph (*a*) is replaced by the following:

Limitation of FEDE

(12.4) Where, as a result of a transaction that occurs after May 6, 1974, an amount becomes receivable by a taxpayer at a particular time in a taxation year and the consideration given by the taxpayer for the amount receivable is property (other than a foreign resource property) or services, the original cost of which to the taxpayer can reasonably be regarded as having been primarily foreign exploration and development expenses of the taxpayer (or would have been so regarded if they had been incurred by the taxpayer after 1971 and the definition "foreign exploration and development expenses" in subsection (15) were read without reference to paragraph (*k*) of that definition), the following rules apply:

(8) Paragraph 66(12.4)(*b*) of the Act is replaced by the following:

(*b*) where the amount receivable exceeds the total of the taxpayer's foreign exploration and development expenses incurred before that

time to the extent that those expenses were not deducted or deductible, as the case may be, in computing the taxpayer's income for a preceding taxation year, there shall be included in the amount referred to in paragraph 59(3.2)(*a*) the amount, if any, by which the amount receivable exceeds the total of

(i) the taxpayer's foreign exploration and development expenses incurred before that time to the extent that those expenses were not deducted or deductible, as the case may be, in computing the taxpayer's income for a preceding taxation year, and

(ii) the amount, designated by the taxpayer in prescribed form filed with the taxpayer's return of income for the year, not exceeding the portion of the amount receivable for which the consideration given by the taxpayer was property (other than a foreign resource property) or services, the original cost of which to the taxpayer can reasonably be regarded as having been primarily

(A) specified foreign exploration and development expenses in respect of a country, or

(B) foreign resource expenses in respect of a country; and

(9) Section 66 of the Act is amended by adding the following after subsection (12.4):

Limitations of foreign resource expenses

(12.41) Where a particular amount described in subsection (12.4) becomes receivable by a taxpayer at a particular time, there shall at that time be included in the value determined for G in the definition "cumulative foreign resource expense" in subsection 66.21(1) in respect of the taxpayer and a country the amount designated under subparagraph (12.4)(*b*)(ii) by the taxpayer in respect of the particular amount and the country.

Partnerships

(12.42) For the purposes of subsections (12.4) and (12.41), where a person or partnership is a member of a particular partnership and a particular amount described in subsection (12.4) becomes receivable by the particular partnership in a fiscal period of the particular partnership,

(*a*) the member's share of the particular amount is deemed to be an amount that became receivable by the member at the end of the fiscal period; and

(*b*) the amount deemed by paragraph (*a*) to be an amount receivable by the member is deemed to be an amount

(i) that is described in subsection (12.4) in respect of the member, and

(ii) that has the same attributes for the member as it did for the particular partnership.

(10) Subsection 66(13.1) of the Act is replaced by the following:

Short taxation year

(13.1) Where a taxpayer has a taxation year that is less than 51 weeks, the amount determined in respect of the year under each of subparagraph (4)(*b*)(i), paragraph 66.2(2)(*c*), subparagraph (*b*)(i) of the definition "global foreign resource limit" in subsection 66.21(1), subparagraph 66.21(4)(*a*)(i), clause 66.21(4)(*a*)(ii)(B) and paragraphs 66.4(2)(*b*) and 66.7(2.3)(*a*), (4)(*a*) and (5)(*a*) shall not exceed that proportion of the amount otherwise determined that the number of days in the year is of 365.

(11) Paragraph (*c*) of the definition "Canadian resource property" in subsection 66(15) of the Act is replaced by the following:

(*c*) any oil or gas well in Canada or any real property in Canada the principal value of which depends on its petroleum or natural gas content (but not including any depreciable property),

(12) Paragraph (*f*) of the definition "Canadian resource property" in subsection 66(15) of the Act is replaced by the following:

(*f*) any real property in Canada the principal value of which depends on its mineral resource content (but not including any depreciable property), or

(13) Paragraph (*b*) of the definition "foreign exploration and development expenses" in subsection 66(15) of the Act is replaced by the following:

(*b*) any expense incurred by the taxpayer for the purpose of determining the existence, location, extent or quality of a mineral

resource outside Canada, including any expense incurred in the course of

(i) prospecting,

(ii) carrying out geological, geophysical or geochemical surveys,

(iii) drilling by rotary, diamond, percussion or other method, or

(iv) trenching, digging test pits and preliminary sampling,

(14) The definition "foreign exploration and development expenses" in subsection 66(15) of the Act is amended by striking out the word "or" at the end of paragraph (*h*) and by adding the following after paragraph (*i*):

(*j*) an expenditure that is the cost, or any part of the cost, to the taxpayer of any depreciable property of a prescribed class that was acquired after **ANNOUNCEMENT DATE**,

(*k*) foreign resource expenses in respect of a country, or

(*l*) an expenditure made after February 27, 2000 by the taxpayer unless the expenditure was made

(i) pursuant to an agreement in writing made by the taxpayer before February 28, 2000,

(ii) for the acquisition of foreign resource property by the taxpayer, or

(iii) for the purpose of

(A) enhancing the value of foreign resource property that the taxpayer owned at the time the expenditure was incurred or that the taxpayer had a reasonable expectation of owning after that time, or

(B) assisting in evaluating whether a foreign resource property is to be acquired by the taxpayer;

(15) The definitions "original owner" and "predecessor owner" in subsection 66(15) of the Act are replaced by the following:

"original owner"
« propriétaire obligé »

"original owner" of a Canadian resource property or a foreign resource property means a person

(*a*) who owned the property and disposed of it to a corporation that acquired it in circumstances in which subsection 29(25) of the *Income Tax Application Rules* or subsection 66.7(1), (2), (2.3), (3), (4) or (5) applies, or would apply if the corporation had continued to own the property, to the corporation in respect of the property, and

(*b*) who would, but for subsection 66.7(12), (13), (13.1) or (17), as the case may be, be entitled in computing that person's income for a taxation year that ends after that person disposed of the property to a deduction under section 29 of the *Income Tax Application Rules* or subsection (2), (3) or (4), 66.1(2) or (3), 66.2(2), 66.21(4) or 66.4(2) of this Act in respect of expenses described in subparagraph 29(25)(*c*)(i) or (ii) of that Act, Canadian exploration and development expenses, foreign resource pool expenses, Canadian exploration expenses, Canadian development expenses or Canadian oil and gas property expenses incurred by the person before the person disposed of the property;

"predecessor owner"
« propriétaire antérieur »

"predecessor owner" of a Canadian resource property or a foreign resource property means a corporation

(*a*) that acquired the property in circumstances in which subsection 29(25) of the *Income Tax Application Rules* or subsection 66.7(1), (2), (2.3), (3), (4) or (5) applies, or would apply if the corporation had continued to own the property, to the corporation in respect of the property,

(*b*) that disposed of the property to another corporation that acquired it in circumstances in which subsection 29(25) of the *Income Tax Application Rules* or subsection 66.7(1), (2), (2.3), (3), (4) or (5) applies, or would apply if the other corporation had continued to own the property, to the other corporation in respect of the property, and

(*c*) that would, but for subsection 66.7(14), (15), (15.1) or (17), as the case may be, be entitled in computing its income for a taxation year ending after it disposed of the property to a deduction under subsection 29(25) of the *Income Tax Application Rules* or subsection 66.7(1), (2), (2.3), (3), (4) or (5) in respect of expenses incurred by an original owner of the property;

(16) Subsection 66(15) of the Act is amended by adding the following in alphabetical order:

"specified foreign exploration and development expense"
« frais d'exploration et d'aménagement à l'étranger déterminés »

"specified foreign exploration and development expense" of a taxpayer in respect of a country (other than Canada) means an amount that is included in the taxpayer's foreign exploration and development expenses and that is

(*a*) a drilling or exploration expense, including any general geological or geophysical expense, incurred by the taxpayer on or in respect of exploring or drilling for petroleum or natural gas in that country,

(*a*.1) an expense incurred by the taxpayer after **ANNOUNCEMENT DATE** (otherwise than pursuant to an agreement in writing made before **[ANNOUNCEMENT DATE +1]**) for the purpose of determining the existence, location, extent or quality of a mineral resource in that country, including any expense incurred in the course of

(i) prospecting,

(ii) carrying out geological, geophysical or geochemical surveys,

(iii) drilling by rotary, diamond, percussion or other methods, or

(iv) trenching, digging test pits and preliminary sampling,

(*b*) a prospecting, exploration or development expense incurred by the taxpayer before [**ANNOUNCEMENT DATE +1**] (or after **ANNOUNCEMENT DATE** pursuant to an agreement in writing made before [**ANNOUNCEMENT DATE +1**]) in searching for minerals in that country,

(*c*) the cost to the taxpayer of the taxpayer's foreign resource property in respect of that country,

(*d*) an annual payment made by the taxpayer in a taxation year of the taxpayer for the preservation of a foreign resource property in respect of that country,

(*e*) an amount deemed by subsection 21(2) or (4) to be a foreign exploration and development expense incurred by the taxpayer, to the extent that it can reasonably be considered to relate to an amount that, without reference to this paragraph and paragraph (*f*), would be a specified foreign exploration and development expense in respect of that country, or

(*f*) subject to section 66.8, the taxpayer's share of the specified foreign exploration and development expenses of a partnership incurred in respect of that country in a fiscal period of the partnership if, at the end of that period, the taxpayer was a member of the partnership.

(17) Subsection 66(15.1) of the Act is replaced by the following:

Other definitions

(15.1) The definitions in subsections 66.1(6), 66.2(5), <u>66.21(1)</u>, 66.4(5) and 66.5(2) apply <u>in</u> this section.

(18) Subsection 66(18) of the Act is replaced by the following:

Members of partnerships

(18) For the purposes of this section, subsection 21(2), sections 59.1 and 66.1 to 66.7, paragraph (*d*) of the definition "investment expense" in subsection 110.6(1) and the descriptions of C and D in subsection 211.91(1), where a person's share of an outlay or expense made or incurred by a partnership in a fiscal period of the partnership is included in respect of the person under paragraph (*d*) of the definition "foreign exploration and development expenses" in subsection (15), paragraph (*h*) of the definition "Canadian exploration expense" in subsection 66.1(6), paragraph (*f*) of the definition "Canadian development expense" in subsection 66.2(5), <u>paragraph (*e*) of the definition "foreign resource</u>

expenses" in subsection 66.21(1) or paragraph (*b*) of the definition "Canadian oil and gas property expense" in subsection 66.4(5), the portion of the outlay or expense so included is deemed, except for the purposes of applying the definitions "foreign exploration and development expenses", "Canadian exploration expense", "Canadian development expense", "foreign resource expense" and "Canadian oil and gas property expense" in respect of the person, to be made or incurred by the person at the end of that fiscal period.

(19) Subsection (1) applies to the 2000 and subsequent taxation years.

(20) Subsection (2) applies to taxation years that end after February 27, 2000, except that the portion of paragraph 66(4)(*b*) of the Act before subparagraph (ii), as enacted by subsection (2), shall read as follows in respect of cessations of residence that occurred before February 28, 2000:

"(*b*) of that total, the greatest of

(i) the amount, if any, claimed by the taxpayer not exceeding 10% of the amount determined under paragraph (*a*) in respect of the taxpayer for the year,

(i.1) if the taxpayer ceased to be resident in Canada immediately after the end of the year, the amount, if any, claimed by the taxpayer not exceeding the amount determined under paragraph (*a*) in respect of the taxpayer for the year, and"

(21) Subsections (3) and (5) to (8), subsection 66(12.41) of the Act, as enacted by subsection (9), subsections (10), (11) and (12), paragraph (*k*) of the definition "foreign exploration and development expenses" in subsection 66(15) of the Act, as enacted by subsection (14), and subsection (15) apply to taxation years that begin after 2000.

(22) Subsections 66(4.1) and (4.2) of the Act, as enacted by subsection (4), apply to taxation years of a taxpayer that begin after the earlier of

(*a*) December 31, 1999; and

(*b*) where, for the purposes of subsection 72(9), a date is designated in writing by the taxpayer and the designation is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act receives royal assent, the later of

(i) the date so designated, and

(ii) December 31, 1994.

(23) Subsection 66(4.3) of the Act, as enacted by subsection (4), applies to the 1998 and subsequent taxation years.

(24) Subsection 66(12.42) of the Act, as enacted by subsection (9), and subsection (18) apply to fiscal periods that begin after 2000.

(25) Subsection (13) applies to expenses incurred after ANNOUNCEMENT DATE, other than expenses incurred pursuant to an agreement in writing made before [ANNOUNCEMENT DATE + 1].

(26) Paragraph (*j*) of the definition "foreign exploration and development expenses" in subsection 66(15) of the Act, as enacted by subsection (14), and subsection (17) apply after 2000.

(27) Paragraph (*l*) of the definition "foreign exploration and development expenses" in subsection 66(15) of the Act, as enacted by subsection (14), applies after February 27, 2000.

(28) Subsection (16) applies after 1994.

28. (1) The description of L in the definition "cumulative Canadian exploration expense" in subsection 66.1(6) of the Act is replaced by the following:

L is that portion of the total of all amounts each of which was deducted by the taxpayer under subsection 127(5) or (6) for a taxation year that ended before that time and that can reasonably be attributed to a qualified Canadian exploration expenditure or a flow-through mining expenditure (within the meaning assigned by subsection 127(9)) made in a preceding taxation year, and

(2) Subsection (1) applies after October 17, 2000.

29. (1) The Act is amended by adding the following after section 66.2:

Definitions

66.21 (1) The definitions in this subsection apply in this section.

"adjusted cumulative foreign resource expense"
« frais cumulatifs rajustés relatifs à des ressources à l'étranger »

"adjusted cumulative foreign resource expense" of a taxpayer in respect of a country at the end of a taxation year means the total of

(*a*) the cumulative foreign resource expense of the taxpayer in respect of that country at the end of the year; and

(*b*) the amount, if any, by which

(i) the total determined under paragraph 66.7(13.2)(*a*) in respect of that country and the taxpayer for the year

exceeds

(ii) the amount that would, but for paragraph (3)(*c*), be determined under subsection (3) in respect of that country and the taxpayer for the year.

"cumulative foreign resource expense"
« frais cumulatifs relatifs à des ressources à l'étranger »

"cumulative foreign resource expense" of a taxpayer in respect of a country other than Canada at a particular time means the amount determined by the formula

$$(A + B + C + D) - (E + F + G + H + I + J)$$

where

A is the total of all foreign resource expenses, in respect of that country, made or incurred by the taxpayer

(*a*) before the particular time, and

(*b*) at a time (in this definition referred to as a "resident time")

(i) at which the taxpayer was resident in Canada, and

(ii) where the taxpayer became resident in Canada before the particular time, that is after the last time (before the particular time) that the taxpayer became resident in Canada;

B is the total of all amounts required to be included in computing the amount referred to in paragraph 59(3.2)(*c*.1) in respect of that country for taxation years that ended before the particular time and at a resident time;

C is the total of all amounts referred to in the description of F or G that are established by the taxpayer to have become a bad debt before the particular time and at a resident time;

D is the total of all specified amounts determined under subsection 66.7(13.2) in respect of the taxpayer and that country for taxation years that ended before the particular time and at a resident time;

E is the total of all amounts deducted, in computing the taxpayer's income for a taxation year that ended before the particular time and at a resident time, in respect of the taxpayer's cumulative foreign resource expense in respect of that country;

F is the total of all amounts each of which is an amount in respect of a foreign resource property in respect of that country (in this description referred to as the "particular property") disposed of by the taxpayer equal to the amount, if any, by which

(*a*) the amount designated under subparagraph 59(1)(*b*)(ii) by the taxpayer in respect of the portion of the proceeds of that disposition that became receivable before the particular time and at a resident time

exceeds

(*b*) the amount, if any, by which

(i) the total of all amounts that would be determined under paragraph 66.7(2.3)(*a*), immediately before the time (in this paragraph referred to as the "relevant time") when such proceeds of disposition became receivable, in respect of the taxpayer, that country and an original owner of the particular property (or of any other property acquired by the taxpayer with the particular property in circumstances to which subsection 66.7(2.3) applied and in respect of which the proceeds of disposition became receivable by the taxpayer at the relevant time) if

(A) amounts that became receivable at or after the relevant time were not taken into account,

(B) paragraph 66.7(2.3)(*a*) were read without reference to "30% of", and

(C) no reduction under subsection 80(8) at or after the relevant time were taken into account,

exceeds the total of

(ii) all amounts that would be determined under paragraph 66.7(2.3)(*a*) at the relevant time in respect of the taxpayer, that country and an original owner of the particular property (or of that other property) if

(A) amounts that became receivable after the relevant time were not taken into account,

(B) paragraph 66.7(2.3)(*a*) were read without reference to "30% of", and

(C) no reduction under subsection 80(8) at or after the relevant time were taken into account, and

(iii) the portion of the amount otherwise determined under this paragraph that was otherwise applied to reduce the amount otherwise determined under this description;

G is the total of all amounts, in respect of that country, each of which is an amount included in the amount determined under this description by reason of subsection 66(12.41) that became receivable by the taxpayer before the particular time and at a resident time;

H is the total of all amounts each of which is an amount received before the particular time and at a resident time on account of any amount referred to in the description of C;

I is the total of all amounts each of which is an amount by which the cumulative foreign resource expense of the taxpayer in respect of that country is required, by reason of subsection 80(8), to be reduced at or before the particular time and at a resident time; and

J is the total of all amounts each of which is an amount that is required to be deducted, before the particular time and at a resident time, under paragraph 66.7(13.1)(*a*) in computing the taxpayer's cumulative foreign resource expense.

"foreign resource expense"
« frais relatifs à des ressources à l'étranger »

"foreign resource expense" of a taxpayer in respect of a country other than Canada means

(*a*) any drilling or exploration expense, including any general geological or geophysical expense, incurred by the taxpayer on or in respect of exploring or drilling for petroleum or natural gas in that country,

(*b*) any expense incurred by the taxpayer for the purpose of determining the existence, location, extent or quality of a mineral resource in that country, including any expense incurred in the course of

(i) prospecting,

(ii) carrying out geological, geophysical or geochemical surveys,

(iii) drilling by rotary, diamond, percussion or other methods, or

(iv) trenching, digging test pits and preliminary sampling,

(*c*) the cost to the taxpayer of any of the taxpayer's foreign resource property in respect of that country,

(*d*) any annual payment made by the taxpayer for the preservation of a foreign resource property in respect of that country, and

(*e*) subject to section 66.8, the taxpayer's share of an expense, cost or payment referred to in any of paragraphs (*a*) to (*d*) that is made or incurred by a partnership in a fiscal period of the partnership that begins after 2000 if, at the end of that period, the taxpayer was a member of the partnership

but does not include

(*f*) an expenditure that is the cost, or any part of the cost, to the taxpayer of any depreciable property of a prescribed class,

(*g*) an expenditure incurred at any time after the commencement of production from a foreign resource property of the taxpayer in

order to evaluate the feasibility of a method of recovery of petroleum, natural gas or related hydrocarbons from the portion of a natural reservoir to which the foreign resource property relates,

(*h*) an expenditure (other than a drilling expense) incurred at any time after the commencement of production from a foreign resource property of the taxpayer in order to assist in the recovery of petroleum, natural gas or related hydrocarbons from the portion of a natural reservoir to which the foreign resource property relates,

(*i*) an expenditure, incurred at any time, that relates to the injection of any substance to assist in the recovery of petroleum, natural gas or related hydrocarbons from a natural reservoir,

(*j*) an expenditure incurred by the taxpayer, unless the expenditure was made

(i) for the acquisition of foreign resource property by the taxpayer, or

(ii) for the purpose of

(A) enhancing the value of foreign resource property that the taxpayer owned at the time the expenditure was incurred or that the taxpayer had a reasonable expectation of owning after that time, or

(B) assisting in evaluating whether a foreign resource property is to be acquired by the taxpayer, or

(*k*) the taxpayer's share of any cost or expenditure referred to in any of paragraphs (*f*) to (*j*) that is incurred by a partnership.

"foreign resource income"
« revenu provenant de ressources à l'étranger »

"foreign resource income" of a taxpayer for a taxation year in respect of a country other than Canada means the total of

(*a*) that part of the taxpayer's income for the year, determined without reference to subsections (4) and 66(4), that is reasonably attributable to

(i) the production of petroleum or natural gas from natural accumulations of petroleum or natural gas in that country or from oil or gas wells in that country, or

(ii) the production of minerals from mines in that country;

(*b*) the taxpayer's income for the year from royalties in respect of a natural accumulation of petroleum or natural gas in that country, an oil or gas well in that country or a mine in that country, determined without reference to subsections (4) and 66(4); and

(*c*) all amounts each of which is an amount, in respect of a foreign resource property in respect of that country that has been disposed of by the taxpayer, equal to the amount, if any, by which

(i) the amount included in computing the taxpayer's income for the year by reason of subsection 59(1) in respect of that disposition,

exceeds

(ii) the total of all amounts each of which is that portion of an amount deducted under subsection 66.7(2) in computing the taxpayer's income for the year that

(A) can reasonably be considered to be in respect of the foreign resource property, and

(B) cannot reasonably be considered to have reduced the amount otherwise determined under paragraph (*a*) or (*b*) in respect of the taxpayer for the year.

"foreign resource loss"
« perte résultant de ressources à l'étranger »

"foreign resource loss" of a taxpayer for a taxation year in respect of a country other than Canada means the taxpayer's loss for the year in respect of the country determined in accordance with the definition "foreign resource income" with such modifications as the circumstances require.

"global foreign resource limit"
« limite universelle des frais relatifs à des ressources à l'étranger »

"global foreign resource limit" of a taxpayer for a taxation year means the amount that is the lesser of

(*a*) the amount, if any, by which

(i) the amount determined under subparagraph 66(4)(*b*)(ii) in respect of the taxpayer for the year

exceeds the total of

(ii) the total of all amounts each of which is the maximum amount that the taxpayer would be permitted to deduct, in respect of a country, under subsection (4) in computing the taxpayer's income for the year if, in its application to the year, subsection (4) were read without reference to paragraph (4)(*b*), and

(iii) the amount deducted for the year under subsection 66(4) in computing the taxpayer's income for the year; and

(*b*) the amount, if any, by which

(i) 30% of the total of all amounts each of which is, at the end of the year, the taxpayer's adjusted cumulative foreign resource expense in respect of a country,

exceeds

(ii) the total described in subparagraph (*a*)(ii).

Application of subsection 66(15)

(2) The definitions in subsection 66(15) apply in this section.

Amount to be included in income

(3) For the purpose of paragraph 59(3.2)(*c*.1), the amount referred to in this subsection in respect of a taxpayer for a taxation year is the amount, if any, by which

(*a*) the total of all amounts referred to in the descriptions of E to J in the definition "cumulative foreign resource expense" in subsection (1) that are deducted in computing the taxpayer's cumulative foreign resource expense at the end of the year in respect of a country

exceeds the total of

(*b*) the total of all amounts referred to in the descriptions of A to D in the definition "cumulative foreign resource expense" in subsection (1) that are included in computing the taxpayer's cumulative foreign resource expense at the end of the year in respect of the country, and

(*c*) the total determined under paragraph 66.7(13.2)(*a*) for the year in respect of the taxpayer and the country.

Deduction for cumulative foreign resource expense

(4) In computing a taxpayer's income for a taxation year throughout which the taxpayer is resident in Canada, the taxpayer may deduct the amount claimed by the taxpayer, in respect of a country other than Canada, not exceeding the total of

(*a*) the greater of

(i) 10% of a particular amount equal to the taxpayer's adjusted cumulative foreign resource expense in respect of the country at the end of the year, and

(ii) the least of

(A) if the taxpayer ceased to be resident in Canada immediately after the end of the year, the particular amount,

(B) if clause (A) does not apply, 30% of the particular amount,

(C) the amount, if any, by which the taxpayer's foreign resource income for the year in respect of the country exceeds

the portion of the amount, deducted under subsection 66(4) in computing the taxpayer's income for the year, that applies to a source in the country, and

(D) the amount, if any, by which

(I) the total of all amounts each of which is the taxpayer's foreign resource income for the year in respect of a country

exceeds the total of

(II) all amounts each of which is the taxpayer's foreign resource loss for the year in respect of a country, and

(III) the amount deducted under subsection 66(4) in computing the taxpayer's income for the year, and

(*b*) the lesser of

(i) the amount, if any, by which the particular amount exceeds the amount determined for the year under paragraph (*a*) in respect of the taxpayer, and

(ii) that portion of the taxpayer's global foreign resource limit for the year that is designated for the year by the taxpayer, in respect of that country and no other country, in prescribed form filed with the Minister with the taxpayer's return of income for the year.

Individual changing residence

(5) Where at any time in a taxation year an individual becomes or ceases to be resident in Canada,

(*a*) subsection (4) applies to the individual as if the year were the period or periods in the year throughout which the individual was resident in Canada; and

(*b*) for the purpose of applying this section, subsection 66(13.1) does not apply to the individual for the year.

(2) Subsection (1) applies to taxation years that begin after 2000.

30. (1) Section 66.7 of the Act is amended by adding the following after subsection 66.7(2):

Country-by-country successor FEDE allocations

(2.1) For greater certainty, the portion of an amount deducted under subsection (2) in computing a taxpayer's income for a taxation year that can reasonably be considered to be in respect of specified foreign exploration and development expenses of the taxpayer in respect of a country is considered to apply to a source in that country.

Method of allocation

(2.2) For the purpose of subsection (2.1), where a taxpayer has incurred specified foreign exploration and development expenses in respect of two or more countries, an allocation to each of those countries for a taxation year shall be determined in a manner that is

(*a*) reasonable having regard to all the circumstances, including the level and timing of

(i) the taxpayer's specified foreign exploration and development expenses in respect of the country, and

(ii) the profits or gains to which those expenses relate; and

(*b*) not inconsistent with the allocation made under subsection (2.1) for the preceding taxation year.

Successor of foreign resource expenses

(2.3) Subject to subsections (6) and (8), where a corporation (in this subsection referred to as the "successor") acquired a particular foreign resource property in respect of a country (whether by way of a purchase, amalgamation, merger, winding-up or otherwise), there may be deducted by the successor in computing its income for a taxation year an amount not exceeding the total of all amounts each of which is an amount determined in respect of an original owner of the particular property that is the lesser of

(*a*) 30% of the amount, if any, by which

(i) the cumulative foreign resource expense, in respect of the country, of the original owner determined immediately after the disposition of the particular property by the original owner to the extent that it has not been

(A) deducted by the original owner or any predecessor owner of the particular property in computing income for any taxation year,

(B) otherwise deducted in computing the income of the successor for the year, or

(C) deducted by the successor in computing its income for any preceding taxation year

exceeds the total of

(ii) all amounts each of which is an amount (other than any portion of the amount that can reasonably be considered to result in a reduction of the amount otherwise determined under this paragraph in respect of another original owner of a relevant resource property who is not a predecessor owner of a relevant resource property or who became a predecessor owner of a relevant resource property before the original owner became a predecessor owner of a relevant resource property) that became receivable by a predecessor owner of the particular property, or by the successor in the year or a preceding taxation year, and that

(A) was included by the predecessor owner or the successor in computing an amount determined under paragraph (*a*) of the description of F in the definition "cumulative foreign resource expense" in subsection 66.21(1) at the end of the year, and

(B) can reasonably be regarded as attributable to the disposition of a property (in this subparagraph referred to as a "relevant resource property") that is

(I) the particular property, or

(II) another foreign resource property in respect of the country that was acquired from the original owner with the particular property by the successor or a predecessor owner of the particular property, and

(iii) all amounts each of which is an amount by which the amount described in this paragraph is required by reason of subsection 80(8) to be reduced at or before the end of the year, and

(*b*) the amount, if any, by which the total of

(i) the part of the successor's income for the year that can reasonably be regarded as attributable to production from the particular property, computed as if no deduction were permitted

under this section or any of sections 65 to 66.5, except that, where the successor acquired the particular property from the original owner at any time in the year (otherwise than by way of an amalgamation or merger or solely by reason of the application of paragraph (10)(*c*)) and did not deal with the original owner at arm's length at that time, the amount determined under this subparagraph is deemed to be nil, and

(ii) unless the amount determined under subparagraph (i) is nil by reason of the exception provided under that subparagraph, the lesser of

(A) the total of all amounts each of which is the amount designated by the successor for the year in respect of a Canadian resource property owned by the original owner immediately before being acquired with the particular property by the successor or a predecessor owner of the particular property, not exceeding the amount included in the successor's income for the year, computed as if no deduction were permitted under section 29 of the *Income Tax Application Rules*, this section or any of sections 65 to 66.5, that can reasonably be regarded as being attributable to the production from the Canadian resource property, and

(B) the amount, if any, by which 10% of the amount described in paragraph (*a*) for the year, in respect of the original owner, exceeds the total of all amounts each of which would, but for this subparagraph, clause (2)(*b*)(iii)(B) and subparagraph (10)(*h*)(vi), be determined under this paragraph for the year in respect of the particular property or other foreign resource property, in respect of the country, owned by the original owner immediately before being acquired with the particular property by the successor or by a predecessor owner of the particular property

exceeds the total of

(iii) all other amounts each of which is an amount deducted for the year under this subsection or subsection (2) that can reasonably be regarded as attributable to

(A) the part of its income for the year described in subparagraph (i) in respect of the particular property, or

(B) a part of its income for the year described in clause (ii)(A) in respect of which an amount is designated by the successor under clause (ii)(A), and

(iv) all amounts added by reason of subsection 80(13) in computing the amount determined under subparagraph (i),

and income in respect of which an amount is designated under clause (*b*)(ii)(A) is, for the purposes of clause 29(25)(*d*)(i)(B) of the *Income Tax Application Rules*, clauses (1)(*b*)(i)(C), (3)(*b*)(i)(C), (4)(*b*)(i)(B) and (5)(*b*)(i)(B) and subparagraph (10)(*g*)(iii), deemed not to be attributable to production from a Canadian resource property.

(2) The portion of subsection 66.7(8) of the Act before paragraph (*a*) is replaced by the following:

Application of ss. (2) and (2.3)

(8) Subsections (2) and (2.3) apply only to a corporation that has acquired a particular foreign resource property

(3) The portion of subsection 66.7(10) of the Act after paragraph (*b*) and before paragraph (*c*) is replaced by the following:

for the purposes of the provisions of the *Income Tax Application Rules* and this Act (other than subsections 66(12.6), (12.601), (12.602), (12.62) and (12.71)) relating to deductions in respect of drilling and exploration expenses, prospecting, exploration and development expenses, Canadian exploration and development expenses, foreign resource pool expenses, Canadian exploration expenses, Canadian development expenses and Canadian oil and gas property expenses (in this subsection referred to as "resource expenses") incurred by the corporation before that time, the following rules apply:

(4) Subparagraphs 66.7(10)(*h*)(v) and (vi) of the Act are replaced by the following:

(v) for the purposes of determining the amounts under paragraphs (2)(*b*) and (2.3)(*b*), to be income from the sources described in subparagraph (iii) or (iv), as the case may be, of the transferee for its taxation year in which that taxation year of the transferor ends, and

(vi) for the purposes of determining the amount under paragraphs (2)(*b*) and (2.3)(*b*), not to be income from the sources described in subparagraph (iii) or (iv), as the case may be, of the transferor for that year,

(5) The portion of subparagraph 66.7(10)(*j*)(ii) of the Act before clause (A) is replaced by the following:

(ii) for the purposes of clause 29(25)(*d*)(i)(B) of the *Income Tax Application Rules* and clauses (1)(*b*)(i)(C) and (2)(*b*)(i)(B), subparagraph (2.3)(*b*)(i) and clauses (3)(*b*)(i)(C), (4)(*b*)(i)(B) and (5)(*b*)(i)(B) for a taxation year ending after that time, the lesser of

(6) Section 66.7 of the Act is amended by adding the following after subsection (13):

Reduction of foreign resource expenses

(13.1) Where in a taxation year an original owner of foreign resource properties in respect of a country disposes of all or substantially all of the original owner's foreign resource properties in circumstances to which subsection (2.3) applies,

(*a*) in determining the cumulative foreign resource expense of the original owner in respect of the country at any time after the time referred to in subparagraph (2.3)(*a*)(i), there shall be deducted the amount of that cumulative foreign resource expense determined immediately after the disposition; and

(*b*) for the purpose of paragraph (2.3)(*a*), the cumulative foreign resource expense of the original owner in respect of the country determined immediately after the disposition that was deducted under subsection 66.21(4) in computing the original owner's income for the year is deemed to be equal to the lesser of

(i) the amount deducted under paragraph (*a*) in respect of the disposition, and

(ii) the amount, if any, by which

(A) the specified amount determined under subsection (13.2) in respect of the original owner and the country for the year

exceeds

(B) the total of all amounts determined under this paragraph in respect of another disposition of foreign resource property in respect of the country made by the original owner before the disposition and in the year.

Specified amount – foreign resource expenses

(13.2) Where in a taxation year an original owner of foreign resource properties in respect of a country disposes of all or substantially all of the original owner's foreign resource properties in circumstances to which subsection (2.3) applies, the specified amount in respect of the country and the original owner for the year for the purposes of clause (13.1)(*b*)(ii)(A) and of determining the value of D in the definition "cumulative foreign resource expense" in subsection 66.21(1) is the lesser of

(*a*) the total of all amounts each of which is the amount, if any, by which

(i) an amount deducted under paragraph (13.1)(*a*) in respect of a disposition in the year by the original owner of foreign resource property in respect of the country

exceeds

(ii) the amount, if any, designated by the original owner in prescribed form filed with the Minister within six months after the end of the year in respect of an amount described under subparagraph (i); and

(*b*) the total of

(i) the amount claimed under subsection 66.21(4) by the original owner in respect of the country for the year, and

(ii) the amount that would, but for paragraph 66.21(3)(*c*), be determined under subsection 66.21(3) in respect of the country and the original owner for the year.

(7) Section 66.7 of the Act is amended by adding the following after subsection (15):

Disposal of foreign resource properties – ss. (2.3)

(15.1) Where in a taxation year a predecessor owner of foreign resource properties disposes of foreign resource properties to a corporation in circumstances to which subsection (2.3) applies,

(*a*) for the purpose of applying that subsection to the predecessor owner in respect of its acquisition of any foreign resource properties owned by it immediately before the disposition, it is deemed, after the disposition, never to have acquired any such properties except for the purposes of

(i) where the predecessor owner and the corporation dealt with each other at arm's length at the time of the disposition or the disposition was by way of an amalgamation or merger, determining an amount deductible under subsection (2.3) for the year, and

(ii) determining the value of F in the definition "cumulative foreign resource expense" in subsection 66.21(1); and

(*b*) where the corporation or another corporation acquires any of the properties on or after the disposition in circumstances to which subsection (2.3) applies, amounts that become receivable by the predecessor owner after the disposition in respect of foreign resource properties retained by it at the time of the disposition are, for the purposes of applying subsection (2.3) to the corporation or the other corporation in respect of the acquisition, deemed not to have become receivable by the predecessor owner.

(8) Subsection 66.7(18) of the Act is replaced by the following:

Application of interpretation provisions

(18) The definitions in subsection 66(15) <u>and sections 66.1 to 66.4</u> apply <u>in</u> this section.

(9) Subsections 66.7(2.1) and (2.2) of the Act, as enacted by subsection (1), apply to taxation years of a taxpayer that begin after the earlier of

(*a*) December 31, 1999; and

(*b*) where, for the purposes of subsection 72(9), a date is designated in writing by the taxpayer and the designation is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act receives royal assent, the later of

(i) the date so designated, and

(ii) December 31, 1994.

(10) Subsection 66.7(2.3) of the Act, as enacted by subsection (1), and subsections (2) to (8) apply to taxation years that begin after 2000.

31. (1) Subparagraph 66.8(1)(*a*)(i) of the Act is amended by striking out the word "or" at the end of clause (C) and by replacing clause (D) with the following:

(D) the foreign <u>resource</u> expenses <u>in respect of a country</u> (in this subsection referred to as "<u>country-specific</u> foreign expenses"), <u>or</u>

(E) the foreign exploration and development expenses (in this subsection referred to as "global foreign expenses")

(2) Paragraph 66.8(1)(*b*) of the Act is amended by striking out the word "and" at the end of subparagraph (iii) and by replacing subparagraph (iv) with the following:

(iv) if any remains unapplied, then to reduce (in the order specified by the taxpayer in writing filed with the Minister on or before the taxpayer's filing-due date for the taxpayer's taxation year in which the fiscal period ends or, where no such specification is made, in the order determined by the Minister) the taxpayer's share of country-specific foreign expenses, <u>and</u>

(v) if any remains unapplied, then to reduce the taxpayer's share of global foreign expenses,

(3) Subsections (1) and (2) apply to fiscal periods that begin after 2000.

32. (1) The portion of paragraph 70(5.1)(*d*) of the Act before the formula is replaced by the following:

(*d*) for the purpose of determining, after that time, <u>the amount required by paragraph 14(1)(*b*) to be included in computing the income of the beneficiary</u> in respect of any subsequent disposition of the property of the business, there shall be added to the amount determined for Q in the definition "cumulative eligible capital" in subsection 14(5) the amount determined by the formula

(2) Paragraph 70(5.2)(*a*) of the Act is replaced by the following:

(*a*) the taxpayer <u>is</u> deemed to have, immediately before the taxpayer's death, disposed of each Canadian resource property and foreign resource property of the taxpayer and received proceeds of disposition

for that property equal to its fair market value immediately before the death;

(*a*.1) subject to subparagraph (*b*)(ii), any particular person who as a consequence of the taxpayer's death acquires any property that is deemed by paragraph (*a*) to have been disposed of by the taxpayer is deemed to have acquired the property at the time of the death at a cost equal to the fair market value of the property immediately before the death;

(3) Subparagraph 70(5.2)(*b*)(ii) of the Act is replaced by the following:

(ii) the spouse, common-law partner or trust, as the case may be, is deemed to have acquired the property at the time of the death at a cost equal to the amount determined in respect of the disposition under subparagraph (i);

(4) Subsection (1) applies in respect of taxation years that end after February 27, 2000.

(5) Paragraph 70(5.2)(*a*) of the Act, as enacted by subsection (2), and subsection (3) apply to taxation years that begin after 2000.

(6) Paragraph 70(5.2)(*a*.1) of the Act, as enacted by subsection (2), applies to acquisitions that occur after 1992.

33. (1) Subsection 79.1(2) of the Act is replaced by the following:

Seizure of property

(2) Subject to subsection (2.1) and for the purpose of this section, a property is seized at any time by a person in respect of a debt where

(*a*) the beneficial ownership of the property is acquired or reacquired at that time by the person; and

(*b*) the acquisition or reacquisition of the property is in consequence of another person's failure to pay to the person all or part of the specified amount of the debt.

Exception

(2.1) For the purpose of this section, foreign resource property is deemed not to be seized at any time from

(*a*) an individual or a corporation, if the individual or corporation is non-resident at that time; or

(*b*) a partnership (other than a partnership each member of which is resident in Canada at that time).

(2) Subsection (1) applies in respect of property acquired or reacquired after February 27, 2000.

34. (1) The portion of the definition "successor pool" in subsection 80(1) of the Act before paragraph (*f*) is replaced by the following:

"successor pool"
« compte de société remplaçante »

"successor pool" at any time for a commercial obligation and in respect of an amount determined in relation to a debtor means the portion of that amount that would be deductible under subsection 66.7(2), (2.3), (3), (4) or (5), as the case may be, in computing the debtor's income for the taxation year that includes that time, if

(*a*) the debtor had sufficient incomes from all sources,

(*b*) subsection (8) did not apply to reduce the amount so determined at that time,

(*c*) the year ended immediately after that time, and

(*d*) paragraphs 66.7(2.3)(*a*), (4)(*a*) and (5)(*a*) were read without reference to the expressions "30% of", "30% of" and "10% of", respectively,

except that the successor pool at that time for the obligation is deemed to be nil unless

(*e*) the obligation was issued by the debtor before, and not in contemplation of, the event described in paragraph (8)(*a*) that gives rise to the deductibility under subsection 66.7(2), (2.3), (3), (4) or (5), as the case may be, of all or part of that amount in computing the debtor's income, or

(2) Paragraph 80(2)(*d*) of the Act is replaced by the following:

(*d*) the applicable fraction of the unapplied portion of a forgiven amount at any time in respect of an obligation issued by the debtor is

(i) in respect of a loss for a taxation year that begins after February 27, 2000, 2/3, and

(ii) in respect of a loss for any other taxation year, the fraction required to be used under section 38 for that year;

(3) Paragraph 80(8)(*a*) of the Act is replaced by the following:

(*a*) where the debtor is a corporation resident in Canada throughout that year, each particular amount that would be determined in respect of the debtor under paragraph 66.7(2)(*a*), (2.3)(*a*), (3)(*a*), (4)(*a*) or (5)(*a*) if paragraphs 66.7(2.3)(*a*), (4)(*a*) and (5)(*a*) were read without reference to the expressions "30% of", "30% of" and "10% of", respectively, as a consequence of the acquisition of control of the debtor by a person or group of persons, the debtor ceasing to be exempt from tax under this Part on its taxable income or the acquisition of properties by the debtor by way of an amalgamation or merger, where the amount so applied does not exceed the successor pool immediately after that time for the obligation and in respect of the particular amount;

(4) Subsection 80(8) of the Act is amended by striking out the word "and" at the end of paragraph (*d*), by adding the word "and" at the end of paragraph (*e*) and by adding the following after paragraph (*e*):

(*f*) the cumulative foreign resource expense (within the meaning assigned by subsection 66.21(1)) of the debtor in respect of a country.

(5) Clause 80(12)(*a*)(ii)(B) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(6) Subparagraph (*a*)(ii) of the description of D in subsection 80(13) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(7) Paragraph (*b*) of the description of E in subsection 80(13) of the Act is amended by replacing the reference to the number "0.75" with a reference to the fraction "1/2".

(8) Subsections (1), (3) and (4) apply to taxation years that begin after 2000.

(9) Subsections (2) and (5) to (7) apply to taxation years that end after February 27, 2000 except that, for a taxation year of a debtor that includes either February 28, 2000 or October 17, 2000

(*a*) the reference to the word "twice" in clause 80(12)(*a*)(ii)(B) of the Act, as enacted by subsection (5), and in subparagraph (*a*)(ii) of the description of D in subsection 80(13) of the Act, as enacted by subsection (6), shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the debtor for the year, multiplied by"; and

(*b*) the reference to the fraction "1/2" in paragraph (*b*) of the description of E in subsection 80(13) of the Act, as enacted by subsection (7), shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the debtor for the year.

35. (1) Subsection 80.01(10) of the Act is amended by replacing the reference to the number "0.75" in the formula with a reference to the number "0.5".

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, where a taxation year of a debtor includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in subsection 80.01(10) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the debtor for the year.

36. (1) Subsection 84.1(2.1) of the Act is amended by replacing the references to the expression "4/3 of" with references to the word "twice" and by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the references in subsection 84.1(2.1) of the Act, as enacted by subsection (1), to the word "twice" shall be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year multiplied by" and the reference to the fraction "1/2" shall be read as a reference to the fraction in

paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year.

37. (1) The descriptions of D and E in paragraph 85(1)(*d*.1) of the Act are replaced by the following:

D is the amount, if any, that would be included under subsection 14(1) in computing the taxpayer's income as a result of the disposition if the values determined for C and D in paragraph 14(1)(*b*) were zero, and

E is the amount, if any, that would be included under subsection 14(1) in computing the taxpayer's income as a result of the disposition if the value determined for D in paragraph 14(1)(*b*) were zero;

(2) Section 85 of the Act is amended by adding the following after subsection (1.1):

Exception

(1.11) Notwithstanding subsection (1.1), a foreign resource property, or an interest in a partnership that derives all or part of its value from one or more foreign resource properties, is not an eligible property of a taxpayer in respect of a disposition by the taxpayer to a corporation where

(*a*) the taxpayer and the corporation do not deal with each other at arm's length; and

(*b*) it is reasonable to conclude that one of the purposes of the disposition, or a series of transactions or events of which the disposition is a part, is to increase the extent to which any person may claim a deduction under section 126.

(3) Subsection (1) applies in respect of taxation years that end after February 27, 2000.

(4) Subsection (2) applies to dispositions that occur after ANNOUNCEMENT DATE, other than a disposition by a taxpayer that occurs pursuant to an agreement in writing made by the taxpayer on or before that date.

38. (1) The Act is amended by adding the following after section 86:

Eligible distribution not included in income

86.1 (1) Notwithstanding any other provision of this Part,

(*a*) the amount of an eligible distribution received by a taxpayer shall not be included in computing the income of the taxpayer; and

(*b*) subsection 52(2) does not apply to the eligible distribution received by the taxpayer.

Eligible distribution

(2) For the purposes of this section and Part XI, a distribution by a particular corporation that is received by a taxpayer is an eligible distribution if

(*a*) the distribution is with respect to all of the taxpayer's common shares of the capital stock of the particular corporation (in this section referred to as the "original shares");

(*b*) the distribution consists solely of common shares of the capital stock of another corporation that were owned by the particular corporation immediately before their distribution to the taxpayer (in this section referred to as the "spin-off shares");

(*c*) in the case of a distribution that is not prescribed,

(i) at the time of the distribution, both corporations are resident in the United States and were never resident in Canada,

(ii) at the time of the distribution, the shares of the class that includes the original shares are widely held and actively traded on a prescribed stock exchange in the United States, and

(iii) under the *United States Internal Revenue Code* applicable to the distribution, the shareholders of the particular corporation who are resident in the United States are not taxable in respect of the distribution;

(*d*) in the case of a distribution that is prescribed,

(i) at the time of the distribution, both corporations are resident in the same country, other than the United States, with which Canada has a tax treaty (in this section referred to as the "foreign country") and were never resident in Canada,

(ii) at the time of the distribution, the shares of the class that includes the original shares are widely held and actively traded on a prescribed stock exchange,

(iii) under the law of the foreign country, those shareholders of the particular corporation who are resident in that country are not taxable in respect of the distribution, and

(iv) the distribution is prescribed subject to such terms and conditions as are considered appropriate in the circumstances;

(*e*) before the end of the sixth month following the day on which the particular corporation first distributes a spin-off share in respect of the distribution, the particular corporation provides to the Minister information satisfactory to the Minister establishing

(i) that, at the time of the distribution, the shares of the class that includes the original shares are widely held and actively traded on a prescribed stock exchange,

(ii) that the particular corporation and the other corporation referred to in paragraph (*b*) were never resident in Canada,

(iii) the date of the distribution,

(iv) the type and fair market value of each property distributed to residents of Canada,

(v) the name and address of each resident of Canada that received property with respect to the distribution,

(vi) in the case of a distribution that is not prescribed, that the distribution is not taxable under the *United States Internal Revenue Code* applicable to the distribution,

(vii) in the case of a distribution that is prescribed, that the distribution is not taxable under the law of the foreign country, and

(vii) such other matters that are required, in prescribed form; and

(*f*) except where Part XI applies in respect of the taxpayer, the taxpayer elects in writing filed with the taxpayer's return of income

for the taxation year in which the distribution occurs (or, in the case of a distribution received before October 18, 2000, filed with the Minister before July 2001) that this section apply to the distribution and provides information satisfactory to the Minister

(i) of the number, cost amount (determined without reference to this section) and the fair market value of the taxpayer's original shares immediately before the distribution,

(ii) of the number, and fair market value, of the spin-off shares immediately after the distribution of those shares to the taxpayer,

(iii) except where the election is filed with the taxpayer's return of income for the year in which the distribution occurs, concerning the amount of the distribution, the manner in which the distribution was reported by the taxpayer and the details of any subsequent disposition of original shares or spin-off shares for the purpose of determining any gains or losses from those dispositions, and

(iv) of such other matters that are required, in prescribed form.

Cost adjustments

(3) Where a spin-off share is distributed by a corporation to a taxpayer pursuant to an eligible distribution with respect to an original share of the taxpayer,

(*a*) there shall be deducted for the purpose of computing the cost amount to the taxpayer of the original share at any time the amount determined by the formula

$$A \times B/C$$

where

A is the cost amount to the taxpayer of the original share, determined without reference to this section,

B is the fair market value of the spin-off share immediately after its distribution to the taxpayer, and

C is the total of

(i) the fair market value of the original share immediately after the distribution of the spin-off share to the taxpayer, and

(ii) the fair market value of the spin-off share immediately after its distribution to the taxpayer; and

(*b*) the cost to the taxpayer of the spin-off share is the amount by which the cost amount of the taxpayer's original share was reduced as a result of paragraph (*a*).

Inventory

(4) For the purpose of calculating the value of the property described in an inventory of a taxpayer's business,

(*a*) an eligible distribution to the taxpayer of a spin-off share that is included in the inventory is deemed not to be an acquisition of property in the fiscal period of the business in which the distribution occurs; and

(*b*) for greater certainty, the value of the spin-off share is to be included in computing the value of the inventory at the end of that fiscal period.

Reassessments

(5) Notwithstanding subsections 152(4) to (5), the Minister may make at any time such assessments, reassessments, determinations and redeterminations that are necessary where information is obtained that the conditions in subparagraph (2)(*c*)(iii) or (*d*)(iii) are not, or are no longer, satisfied.

(2) Subsection (1) applies to distributions received after 1997, except that

(*a*) information referred to in paragraph 86.1(2)(*e*) of the Act, as enacted by subsection (1), is deemed to be provided to the Minister of National Revenue on a timely basis if it is provided to that Minister before the day that is 90 days after the day on which this Act receives royal assent; and

(*b*) the election referred to in paragraph 86.1(2)(*f*) of the Act, as enacted by subsection (1), is deemed to be filed on a timely basis if it is filed with the Minister of National Revenue before the day

that is 90 days after the day on which this Act receives royal assent.

39. (1) Subsection 87(1.2) of the Act is replaced by the following:

New corporation continuation of a predecessor

(1.2) Where there has been an amalgamation of corporations described in paragraph (1.1)(*a*) or of two or more corporations each of which is a subsidiary wholly-owned corporation of the same person, the new corporation is, for the purposes of section 29 of the *Income Tax Application Rules*, subsection 59(3.3) and sections 66, 66.1, 66.2, 66.21, 66.4 and 66.7, deemed to be the same corporation as, and a continuation of, each predecessor corporation, except that this subsection does not affect the determination of any predecessor corporation's fiscal period, taxable income or tax payable.

(2) Subsection (1) applies to amalgamations that occur after 2000.

40. (1) Subsection 88(1.5) of the Act is replaced by the following:

Parent continuation of subsidiary

(1.5) For the purposes of section 29 of the *Income Tax Application Rules*, subsection 59(3.3) and sections 66, 66.1, 66.2, 66.21, 66.4 and 66.7, where the rules in subsection (1) applied to the winding-up of a subsidiary, its parent is deemed to be the same corporation as, and a continuation of, the subsidiary.

(2) Subsection (1) applies to windings-up that occur after 2000.

41. (1) Paragraph (*c*) of the definition "capital dividend account" in subsection 89(1) of the Act is replaced by the following:

(*c*) the total of all amounts each of which is an amount required to have been included under this paragraph as it read in its application to a taxation year that ended before February 28, 2000,

(*c*.1) the amount, if any, by which

(i) 1/2 of the total of all amounts each of which is an amount required by paragraph 14(1)(*b*) to be included in computing the corporation's income in respect of a business carried on by the

corporation for a taxation year that is included in the period and that ended after February 27, 2000 and before October 18, 2000,

exceeds

(ii) where the corporation has deducted an amount under subsection 20(4.2) in respect of a debt established by it to have become a bad debt in a taxation year that is included in the period and that ended after February 27, 2000 and before October 18, 2000, or has an allowable capital loss for such a year because of the application of subsection 20(4.3), the amount determined by the formula:

$$V + W$$

where

V is 1/2 of the value determined for A under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

W is 1/3 of the value determined for B under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

(iii) in any other case, nil,

(*c*.2) the amount, if any, by which

(i) the total of all amounts each of which is an amount required by paragraph 14(1)(*b*) to be included in computing the corporation's income in respect of a business carried on by the corporation for a taxation year that is included in the period and that ends after October 17, 2000,

exceeds

(ii) where the corporation has deducted an amount under subsection 20(4.2) in respect of a debt established by it to have become a bad debt in a taxation year that is included in the period and that ends after October 17, 2000, or has an allowable capital loss for such a year because of the application of subsection 20(4.3), the amount determined by the formula

$$X + Y$$

where

X is the value determined for A under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

Y is 1/3 of the value determined for B under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

(iii) in any other case, nil,

(2) Subsection (1) applies in respect of taxation years that end after February 27, 2000.

42. (1) Subsection 93(2) of the Act is amended by replacing the references to the expression "4/3 of" with references to the word "twice".

(2) Subsection 93(2.1) of the Act is amended by replacing the references to the fraction "3/4" with references to the fraction "1/2".

(3) Subsection 93(2.2) of the Act is amended by replacing the references to the expression "4/3 of" with references to the word "twice".

(4) Subsection 93(2.3) of the Act is amended by replacing the references to the fraction "3/4" with references to the fraction "1/2".

(5) Subsections (1) and (3) apply to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the references to the word "twice" in subsection 93(2) of the Act, as enacted by subsection (1), and in subsection 93(2.2) of the Act, as enacted by subsection (3), shall be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year, multiplied by".

(6) Subsections (2) and (4) apply to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the references to the fraction "1/2" in subsection 93(2.1) of the Act, as enacted by subsection (2), and in subsection 93(2.3) of the Act, as enacted by subsection (4), shall be read as references to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year.

43. (1) The description of A.1 in the definition "foreign accrual property income" in subsection 95(1) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(2) Subsection 95(2) of the Act is amended by adding the following after paragraph (*g*.1):

(*g*.2) for the purpose of computing the foreign accrual property income of a foreign affiliate of any taxpayer resident in Canada for a taxation year of the affiliate, an election made pursuant to paragraph 86.1(2)(*f*) in respect of a distribution received by the affiliate in a particular taxation year of the affiliate is deemed to have been filed under that paragraph by the affiliate if

(i) where there is only one taxpayer resident in Canada in respect of whom the affiliate is a controlled foreign affiliate, the election is filed by the taxpayer with the taxpayer's return of income for the taxpayer's taxation year in which the particular year of the affiliate ends, and

(ii) where there is more than one taxpayer resident in Canada in respect of whom the affiliate is a controlled foreign affiliate, all of those taxpayers jointly elect in writing and each of them files the joint election with the Minister with their return of income for their taxation year in which the particular year of the affiliate ends,

(3) Subsection (1) applies to taxation years that end after February 27, 2000 except that, where a taxation year of a foreign affiliate of a taxpayer includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in the description of A.1 in the definition "foreign accrual property income" in subsection 95(1) of the Act, as enacted by subsection (1), shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the foreign affiliate for the year, multiplied by".

(4) Subsection (2) applies to distributions received after 1997 except that the election referred to in paragraph 95(2)(*g*.2) of the Act, as enacted by subsection (2), is deemed to be filed on a timely basis if it is filed with the Minister of National Revenue before the day that is 90 days after the day on which this Act receives royal assent.

44. (1) Paragraph 96(1)(*d*) of the Act is replaced by the following:

(*d*) each income or loss of the partnership for a taxation year were computed as if

(i) this Act were read without reference to paragraphs 12(1)(*z*.5) and 20(1)(*v*.1), section 34.1, subsection 59(1), paragraph 59(3.2)(*c*.1) and subsections 66.1(1), 66.2(1) and 66.4(1), and

(ii) no deduction were permitted under any of section 29 of the *Income Tax Application Rules*, subsections 34.2(4) and 65(1) and sections 66, 66.1, 66.2, 66.21 and 66.4;

(2) The portion of subsection 96(1.7) of the Act before the formula is replaced by the following:

Gains and losses

(1.7) Notwithstanding subsection (1) or section 38, where in a particular taxation year of a taxpayer, the taxpayer is a member of a partnership with a fiscal period that ends in the particular year, the amount of a taxable capital gain (other than that part of the amount that can reasonably be attributed to an amount deemed under subsection 14(1) to be a taxable capital gain of the partnership), allowable capital loss or allowable business investment loss of the taxpayer for the particular year determined in respect of the partnership is the amount determined by the formula

(3) Clause 96(2.1)(*b*)(iv)(A) of the Act is replaced by the following:

(A) the foreign resource pool expenses, if any, incurred by the partnership in the fiscal period,

(4) Subsections (1) and (3) apply to fiscal periods that begin after 2000.

(5) Subsection (2) applies to taxation years that end after February 27, 2000.

45. (1) Subparagraph 98(3)(*g*)(iii) of the Act is replaced by the following:

(iii) for the purpose of determining after the particular time the amount required by paragraph 14(1)(*b*) to be included in computing the person's income in respect of any subsequent disposition of property of the business, the value determined for Q in the definition "cumulative eligible capital" in subsection 14(5) is deemed to be the amount, if any, of that person's

percentage of the value determined for Q in that definition in respect of the partnership's business immediately before the particular time.

(2) Subparagraph 98(5)(*h*)(ii) of the Act is replaced by the following:

(ii) for the purpose of determining after the particular time the amount required by paragraph 14(1)(*b*) to be included in computing the proprietor's income in respect of any subsequent disposition of property of the business, the value determined for Q in the definition "cumulative eligible capital" in subsection 14(5) is deemed to be the value, if any, determined for Q in that definition in respect of the partnership's business immediately before the particular time.

(3) Subsections (1) and (2) apply in respect of taxation years that end after February 27, 2000.

46. (1) Paragraph 100(1)(*a*) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, where a taxation year of a taxpayer includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in paragraph 100(1)(*a*) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year.

47. (1) Section 101 of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2" and by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, in applying section 101 of the Act, as enacted by subsection (1), to a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000,

(*a*) the reference to the fraction "1/2" in section 101 of the Act, as enacted by subsection (1), shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year; and

(*b*) the reference to the word "twice" in section 101 of the Act, as enacted by subsection (1), shall be read as a reference to the

expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year, multiplied by".

48. (1) The portion of paragraph 104(5.2)(*a*) of the Act before subparagraph (i) is replaced by the following:

(*a*) for the purposes of determining the amounts under subsection 59(1), paragraphs 59(3.2)(*c*) and (*c*.1), subsections 66(4) and 66.2(1), the definition "cumulative Canadian development expense" in subsection 66.2(5), the definition "cumulative foreign resource expense" in subsection 66.21(1), subsection 66.4(1) and the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5), the trust is deemed

(2) Paragraph 104(5.2)(*b*) of the Act is amended by striking out the word "and" at the end of subparagraph (*i*) and by adding the following after subparagraph (*i*):

(*i*.1) include in computing its income for the particular taxation year the amount, if any, determined under paragraph 59(3.2)(*c*.1) in respect of the old taxation year and the amount so included is, for the purpose of determining the value of B in the definition "cumulative foreign resource expense" in subsection 66.21(1), deemed to have been included in computing its income for a preceding taxation year, and

(3) Section 104 of the Act is amended by adding the following after subsection 104(21.3):

Deemed gains

(21.4) Where an amount is designated in respect of a beneficiary by a trust for a particular taxation year of the trust that includes either February 28, 200 or October 17, 2000 and that amount is, because of subsection 104(21), deemed to be a taxable capital gain of the beneficiary from the disposition of capital property for the taxation year of the beneficiary in which the particular taxation year of the trust ends (in this subsection referred to as the "allocated gain"),

(*a*) the beneficiary is deemed to have realized capital gains (in this subsection referred to as the "deemed gains") from the disposition of capital property in the beneficiary's taxation year in which the particular taxation year ends equal to the amount, if any, by which

(i) the amount determined when the amount of the allocated gain is divided by the fraction in paragraph 38(*a*) that applies to the trust for the particular taxation year

exceeds

(ii) the amount claimed by the beneficiary not exceeding the beneficiary's exempt capital gains balance for the year in respect of the trust;

(*b*) notwithstanding subsection 104(21) and except as a consequence of the application of paragraph (*a*), the amount of the allocated gain shall not be included in computing the beneficiary's income for the beneficiary's taxation year in which the particular taxation year ends;

(*c*) the trust shall disclose to the beneficiary in prescribed form the portion of the deemed gains that are in respect of capital gains realized on dispositions of property that occurred before February 28, 2000, after February 27, 2000 and before October 18, 2000, and after October 17, 2000 and, if it does not do so, the deemed gains are deemed to be in respect of capital gains realized on dispositions of property that occurred before February 28, 2000; and

(*d*) where a trust so elects under this paragraph in its return of income for the year,

(i) the portion of the deemed gains that are in respect of capital gains realized on dispositions of property that occurred before February 28, 2000 is deemed to equal that proportion of the deemed gains that the number of days that are in the particular year and before February 28, 2000 is of the number of days that are in the particular year,

(ii) the portion of the deemed gains that are in respect of capital gains realized on dispositions of property that occurred in the year and in the period that began at the beginning of February 28, 2000 and ended at the end of October 17, 2000, is deemed to equal that proportion of the deemed gains that the number of days that are in the year and in that period is of the number of days that are in the particular year, and

(iii) the portion of the deemed gains that are in respect of capital gains realized on dispositions of property that occurred in the year and in the period that begins at the beginning of October 18, 2000 and ends at the end of the particular year, is deemed to equal that proportion of the deemed gains that the number of days that are in the year and in that period is of the number of days that are in the particular year; and

(*e*) no amount may be claimed by the beneficiary under subsection 39.1(3) in respect of the allocated gain.

(4) Subsections (1) and (2) apply to taxation years that begin after 2000.

(5) Subsection (3) applies to taxation years that end after February 27, 2000.

49. (1) The portion of subparagraph 107(2)(*f*)(ii) of the Act before the formula is replaced by the following:

(ii) for the purpose of determining after that time the amount required by paragraph 14(1)(*b*) to be included in computing the taxpayer's income in respect of any subsequent disposition of property of the business, there shall be added to the value otherwise determined for Q in the definition "cumulative eligible capital" in subsection 14(5) the amount determined by the formula

(2) Subparagraph 107(2.2)(*a*)(ii) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(3) Subsections (1) and (2) apply to taxation years that end after February 27, 2000 except that, for a beneficiary's taxation year that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in subparagraph 107(2.2)(*a*)(ii) of the Act, as enacted by subsection (2), shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the beneficiary for the year, multiplied by".

50. (1) The portion of subparagraph 107.4(3)(*e*)(ii) of the Act before the formula is replaced by the following:

(ii) for the purpose of determining after the particular time the amount required by paragraph 14(1)(*b*) to be included in computing the transferee trust's income in respect of any subsequent disposition of the property of the business, there shall be added to the value otherwise determined for Q in the definition "cumulative eligible capital" in subsection 14(5) the amount determined by the formula

(2) Subsection (1) applies in respect of taxation years that end after February 27, 2000.

51. (1) The portion of paragraph 110(1)(*d*) of the Act before subparagraph (i) is replaced by the following:

Employee options

(*d*) an amount equal to 1/2 of the amount of the benefit deemed by subsection 7(1) to have been received by the taxpayer in the year in respect of a security that a particular qualifying person has agreed after February 15, 1984 to sell or issue under an agreement, or in respect of the transfer or other disposition of rights under the agreement, if

(2) Subparagraphs 110(1)(*d*)(ii) and (iii) of the Act are replaced by the following:

(ii) where rights under the agreement were not acquired by the taxpayer as a result of a disposition of rights to which subsection 7(1.4) applied,

(A) the amount payable by the taxpayer to acquire the security under the agreement is not less than the amount by which

(I) the fair market value of the security at the time the agreement was made

exceeds

(II) the amount, if any, paid by the taxpayer to acquire the right to acquire the security, and

(B) at the time immediately after the agreement was made, the taxpayer was dealing at arm's length with

(I) the particular qualifying person,

(II) each other qualifying person that, at the time, was an employer of the taxpayer and was not dealing at arm's length with the particular qualifying person, and

(III) the qualifying person of which the taxpayer had, under the agreement, a right to acquire a security, and

(iii) where rights under the agreement were acquired by the taxpayer as a result of one or more dispositions to which subsection 7(1.4) applied,

(A) the amount payable by the taxpayer to acquire the security under the agreement is not less than the amount that was included, in respect of the security, in the amount determined under subparagraph 7(1.4)(*c*)(ii) with respect to the most recent of those dispositions,

(B) at the time immediately after the agreement the rights under which were the subject of the first of those dispositions (in this subparagraph referred to as the "original agreement") was made, the taxpayer was dealing at arm's length with

(I) the qualifying person that made the original agreement,

(II) each other qualifying person that, at the time, was an employer of the taxpayer and was not dealing at arm's length with the qualifying person that made the original agreement, and

(III) the qualifying person of which the taxpayer had, under the original agreement, a right to acquire a security,

(C) the amount that was included, in respect of each particular security that the taxpayer had a right to acquire under the original agreement, in the amount determined under subparagraph 7(1.4)(*c*)(iv) with respect to the first of those dispositions was not less than the amount by which

(I) the fair market value of the particular security at the time the original agreement was made

exceeded

(II) the amount, if any, paid by the taxpayer to acquire the right to acquire the security, and

(D) for the purpose of determining if the condition in paragraph 7(1.4)(*c*) was satisfied with respect to each of the particular dispositions following the first of those dispositions,

(I) the amount that was included, in respect of each particular security that could be acquired under the agreement the rights under which were the subject of the particular disposition, in the amount determined under subparagraph 7(1.4)(*c*)(iv) with respect to the particular disposition

was not less than

(II) the amount that was included, in respect of the particular security, in the amount determined under subparagraph 7(1.4)(*c*)(ii) with respect to the last of those dispositions preceding the particular disposition;

(3) Subsection 110(1) of the Act is amended by adding the following after paragraph (*d*):

Charitable donation of employee option securities

(*d*.01) subject to subsection (2.1), where the taxpayer disposes of a security acquired in the year by the taxpayer under an agreement referred to in subsection 7(1) by making a gift of the security to a qualified donee (other than a private foundation), an amount in respect of the disposition of the security equal to 1/4 of the lesser of the benefit deemed by paragraph 7(1)(*a*) to have been received by the taxpayer in the year in respect of the acquisition of the security and the amount that would have been that benefit had the value of the security at the time of its acquisition by the taxpayer been equal to the value of the security at the time of the disposition, if

(i) the security is a security described in subparagraph 38(*a*.1)(i),

(ii) the taxpayer acquired the security after February 27, 2000 and before 2002,

(iii) the gift is made in the year and on or before the day that is 30 days after the day on which the taxpayer acquired the security, and

(iv) the taxpayer is entitled to a deduction under paragraph (*d*) in respect of the acquisition of the security;

(4) Paragraphs 110(1)(*d*.1), (*d*.2) and (*d*.3) of the Act are amended by replacing the reference to the fraction "1/4" with a reference to the fraction "1/2".

(5) Subsection 110(1.5) of the Act is replaced by the following:

Determination of amounts relating to employee security options

(1.5) For the purpose of paragraph (1)(*d*),

(*a*) the amount payable by a taxpayer to acquire a security under an agreement referred to in subsection 7(1) shall be determined without reference to any change in the value of a currency of a country other

than Canada, relative to Canadian currency, occurring after the agreement was made;

(*b*) the fair market value of a security at the time an agreement in respect of the security was made shall be determined on the assumption that all specified events associated with the security that occurred after the agreement was made and before the sale or issue of the security or the disposition of the taxpayer's rights under the agreement in respect of the security, as the case may be, had occurred immediately before the agreement was made; and

(*c*) in determining the amount that was included, in respect of a security that a qualifying person has agreed to sell or issue to a taxpayer, in the amount determined under subparagraph 7(1.4)(*c*)(ii) for the purpose of determining if the condition in paragraph 7(1.4)(*c*) was satisfied with respect to a particular disposition, an assumption shall be made that all specified events associated with the security that occurred after the particular disposition and before the sale or issue of the security or the taxpayer's subsequent disposition of rights under the agreement in respect of the security, as the case may be, had occurred immediately before the particular disposition.

Meaning of "specified event"

(1.6) For the purpose of subsection (1.5), a specified event associated with a security is,

(*a*) where the security is a share of the capital stock of a corporation,

(i) a subdivision or consolidation of shares of the capital stock of the corporation,

(ii) a reorganization of share capital of the corporation, and

(iii) a stock dividend of the corporation; and

(*b*) where the security is a unit of a mutual fund trust,

(i) a subdivision or consolidation of the units of the trust, and

(ii) an issuance of units of the trust as payment, or in satisfaction of a person's right to enforce payment, out of the trust's income (determined before the application of subsection 104(6)) or out of the trust's capital gains.

Definitions in subsection 7(7)

(1.7) The definitions in subsection 7(7) apply for the purposes of subsections (1.5) and (1.6).

(6) Section 110 of the Act is amended by adding the following after subsection (2):

Charitable donation – proceeds of disposition of employee option securities

(2.1) Where a taxpayer, in exercising a right to acquire a security that a particular qualifying person has agreed to sell or issue to the taxpayer under an agreement referred to in subsection 7(1), directs a broker or dealer appointed or approved by the particular qualifying person (or by a qualifying person that does not deal at arm's length with the particular qualifying person) to immediately dispose of the security and pay all or a portion of the proceeds of disposition of the security to a qualified donee,

(*a*) if the payment is a gift, the taxpayer is deemed, for the purpose of paragraph (1)(*d*.01), to have disposed of the security by making a gift of the security to the qualified donee at the time the payment is made; and

(*b*) the amount deductible under paragraph (1)(*d*.01) by the taxpayer in respect of the disposition of the security is the amount determined by the formula

$$A \times B/C$$

where

A is the amount that would be deductible under paragraph (1)(*d*.01)in respect of the disposition of the security if this subsection were read without reference to this paragraph,

B is the amount of the payment, and

C is the amount of the proceeds of disposition of the security.

(7) Subsections (1) and (3), paragraph 110(1)(*d*.1) of the Act, as enacted by subsection (4), and subsection (6) apply to the 2000 and subsequent taxation years except that, for the 2000 taxation year,

(*a*) the reference in the portion of paragraph 110(1)(*d*) of the Act before subparagraph 110(1)(*d*)(i), as enacted by subsection (1), and in paragraph 110(1)(*d*.1) of the Act, as enacted by subsection (4), to the fraction "1/2" shall be read as a reference to

(i) the fraction "1/4", if the transaction, event or circumstance as a result of which a benefit is deemed by subsection 7(1) of the Act, as enacted by subsection 1(1), to have been received by a taxpayer occurred before February 28, 2000, and

(ii) the fraction "1/3", if the transaction, event or circumstance as a result of which a benefit is deemed by subsection 7(1) of the Act, as enacted by subsection 1(1), to have been received by a taxpayer occurred after February 27, 2000 and before October 18, 2000; and

(*b*) the reference in the portion of paragraph 110(1)(*d*.01) of the Act before subparagraph 110(1)(*d*.01)(i), as enacted by subsection (3), to the fraction "1/4" shall be read as a reference to the fraction "1/3" if the transaction, event or circumstance as a result of which a benefit is deemed by subsection 7(1) of the Act, as enacted by subsection 1(1), to have been received by a taxpayer occurred after February 27, 2000 and before October 18, 2000.

(8) Subsections (2) and (5) apply to the 1998 and subsequent taxation years.

(9) Paragraphs 110(1)(*d*.2) and (*d*.3) of the Act, as enacted by subsection (4), apply in respect of dispositions and exchanges that occur after February 27, 2000 except that, for dispositions and exchanges that occurred after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" in paragraphs 110(1)(*d*.2) and (*d*.3) of the Act, as enacted by subsection (4), shall be read as a reference to the fraction "1/3".

52. (1) The portion of paragraph 110.1(1)(*d*) of the Act before subparagraph (i) is replaced by the following:

Ecological gifts

(*d*) the total of all amounts each of which is the fair market value of a gift of land, including a servitude for the use and benefit of a dominant land, a covenant or an easement, <u>the fair market value of which is certified by the Minister of the Environment and</u> that is

certified by that Minister, or by a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister, or that person, important to the preservation of Canada's environmental heritage, which gift was made by the corporation in the year or in any of the five preceding taxation years to

(2) Subsection 110.1(2) of the Act is replaced by the following:

Proof of gift

(2) A gift shall not be included for the purpose of determining a deduction under subsection (1) unless the making of the gift is proven by filing with the Minister

(*a*) a receipt for the gift that contains prescribed information;

(*b*) in the case of a gift described in paragraph (1)(*c*), the certificate issued under subsection 33(1) of the *Cultural Property Export and Import Act*; and

(*c*) in the case of a gift described in paragraph (1)(*d*), both certificates referred to in that paragraph.

(3) Subsection 110.1(5) of the Act is replaced by the following:

Ecological gifts

(5) For the purposes of applying subparagraph 69(1)(*b*)(ii), this section and section 207.31 in respect of a gift described in paragraph (1)(*d*) that is made by a taxpayer, the amount that is the fair market value (or, for the purpose of subsection (3), the fair market value otherwise determined) of the gift at the time the gift was made and, subject to subsection (3), the taxpayer's proceeds of disposition of the gift, is deemed to be the amount determined by the Minister of the Environment to be

(*a*) where the gift is land, the fair market value of the gift; or

(*b*) where the gift is a servitude, covenant or easement to which land is subject, the greater of

(i) the fair market value otherwise determined of the gift, and

(ii) the amount by which the fair market value of the land is reduced as a result of the making of the gift.

(4) Subsections (1) to (3) apply in respect of gifts made after February 27, 2000, except that subsection 110.1(2) of the Act, as enacted by subsection (2), shall be read without reference to paragraph 110.1(2)(*b*) in respect of gifts made before ANNOUNCEMENT DATE.

53. (1) Subparagraph (*a*)(ii) of the definition "investment expense" in subsection 110.6(1) of the Act is replaced by the following:

(ii) paragraph 20(1)(*j*) or subsection 65(1), 66(4), 66.1(3), 66.2(2), <u>66.21(4)</u> or 66.4(2),

(2) Paragraph (*d*) of the definition "investment expense" in subsection 110.6(1) of the Act is replaced by the following:

(*d*) 50% of the total of all amounts each of which is an amount deducted under subsection 66(4), 66.1(3), 66.2(2), <u>66.21(4)</u> or 66.4(2) in computing the individual's income for the year in respect of expenses

<u>(i)</u> incurred and renounced under subsection 66(12.6), (12.601), (12.62) or (12.64) by a corporation, or

<u>(ii)</u> incurred by a partnership of which the individual was a specified member in the fiscal period of the partnership in which the expense was incurred, and

(3) Paragraph 110.6(2)(*a*) of the Act is replaced by the following:

(*a*) the amount determined by the formula

$$\$250{,}000 - (A + B + C + D)$$

where

A is the total of all amounts each of which is an amount deducted under this section in computing the individual's taxable income for a preceding taxation year that ended before 1988,

B is the total of all amounts each of which is

(i) 3/4 of an amount deducted under this section in computing the individual's taxable income for a preceding taxation year that ended after 1987 and before 1990 (other than amounts deducted under this section for a taxation year in respect of an amount that was included in computing an individual's income for that year because of subparagraph 14(1)(*a*)(v)), or

(ii) 3/4 of an amount deducted under this section in computing the individual's taxable income for a preceding taxation year that began after February 27, 2000 and ended before October 18, 2000,

C is 2/3 of the total of all amounts each of which is an amount deducted under this section in computing the individual's taxable income

(i) for a preceding taxation year that ended after 1989 and before February 28, 2000, or

(ii) in respect of an amount that was included because of subparagraph 14(1)(*a*)(v) in computing the individual's income for a taxation year that began after 1987 and ended before 1990, and

D is equal to the product obtained when the reciprocal of the fraction in paragraph 38(*a*) that applied to the taxpayer for a preceding taxation year that began before and included either February 28, 2000 or October 17, 2000 is multiplied by 1/2 of the amount deducted under this section in computing the individual's taxable income for that preceding year,

(4) Paragraph 110.6(2.1)(*a*) of the Act is replaced by the following:

(*a*) the amount determined by the formula in paragraph (2)(*a*) in respect of the individual for the year,

(5) Subsection 110.6(4) of the Act is replaced by the following:

Maximum capital gains deduction

(4) Notwithstanding subsection (2) and (2.1), the total amount that may be deducted under this section in computing an individual's income for a taxation year shall not exceed the amount determined by the formula in paragraph (2)(*a*) in respect of the individual for the year.

(6) Paragraph 110.6(12)(*c*) of the Act is replaced by the following:

(*c*) the amount, if any, by which the amount determined by the formula in paragraph (2)(*a*) in respect of the taxpayer's spouse or common-law partner for the taxation year in which that spouse or common-law partner died exceeds the amount deducted under this section for that taxation year by that spouse or common-law partner.

(7) Subsections (1) and (2) apply to taxation years that begin after 2000.

(8) Subsection (3) applies in respect of taxation years that end after February 27, 2000 except that, in computing an individual's taxable income for a taxation year that includes either February 28, 2000 or October 17, 2000, the amount determined by the formula in paragraph 110.6(2)(*a*) of the Act, as enacted by subsection (3), is deemed to be equal to the amount determined under that formula (without reference to this subsection) multiplied by twice the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for that year.

(9) Subsections (4) and (5) apply to taxation years that end after February 27, 2000.

(10) Subsection (6) applies to taxation years that end after February 27, 2000, except that the amount determined under paragraph 110.6(12)(*c*) of the Act, as enacted by subsection (6), in computing a trust's taxable income for its particular taxation year that includes either February 28, 2000 or October 17, 2000 is deemed to be equal to the amount determined under that paragraph (without reference to this subsection) multiplied by the quotient obtained when the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer's spouse or common-law partner for the taxation year in which the spouse or common-law partner died is divided by the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the trust for its particular taxation year.

54. (1) Subclause 111(1)(*e*)(ii)(C)(I) of the Act is replaced by the following:

> (I) the foreign <u>resource pool</u> expenses, if any, incurred by the partnership in that fiscal period,

(2) The description of E in the definition "non-capital loss" in subsection 111(8) of the Act is replaced by the following:

> E is the total of all amounts each of which is the taxpayer's loss for the year from an office, employment, business or property, the taxpayer's allowable business investment loss for the year, an amount deducted under paragraph (1)(*b*) or section 110.6 in computing the taxpayer's taxable income for the year or an amount that may be deducted under <u>any of paragraphs</u> 110(1)(*d*) <u>to</u> (*d*.3), (*f*), (*j*) <u>and</u> (*k*), section 112 <u>and subsections</u> 113(1) <u>and</u> 138(6) in computing the taxpayer's taxable income for the year, and

(3) The first formula in the definition "pre-1986 capital loss balance" in subsection 111(8) of the Act is replaced by the following:

$$(A + B) - (C + D + E \underline{+ E.1})$$

(4) The portion of the definition "pre-1986 capital loss balance" in subsection 111(8) of the Act after the description of C is replaced by the following:

D is 3/4 of the total of all amounts each of which is an amount deducted under section 110.6 in computing the individual's taxable income for a taxation year, preceding the particular year, that

(*a*) ended after 1987 and before 1990, or

(*b*) began after February 27, 2000 and ended before October 18, 2000,

E is 2/3 of the total of all amounts deducted under section 110.6 in computing the individual's taxable income for taxation years, preceding the particular year, that ended after 1989 and before February 28, 2000, and

E.1 is amount determined by the formula

$$J \times (0.5/K)$$

where

J is the amount deducted by the individual under section 110.6 for a taxation year of the individual, preceding the particular year, that includes either February 28, 2000 or October 17, 2000, and

K is the fraction in paragraph 38(*a*) that applies to the individual for the individual's taxation year referred to in the description of J.

(5) Subsection (1) applies to taxation years that begin after 2000.

(6) Subsection (2) applies to the 2000 and subsequent taxation years.

(7) Subsections (3) and (4) apply to taxation years that end after February 27, 2000.

55. (1) Subparagraphs 112(3.2)(*a*)(iii) and (3.3)(*a*)(iii) of the Act are amended by replacing the reference to the fraction "1/4" with a reference to the fraction "1/2".

(2) Subsection (1) applies to dispositions that occur after February 27, 2000 except that, for dispositions that occurred before October 18, 2000, the reference to the fraction "1/2" in subparagraphs 112(3.2)(*a*)(iii) and (3.3)(*a*)(iii) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction "1/3".

56. (1) Paragraph 115(1)(*d*) of the Act is replaced by the following:

(*d*) the deductions permitted by subsection 111(1) and, to the extent that they relate to amounts included in computing the amount determined under any of paragraphs (*a*) to (*c*), the deductions permitted by any of paragraphs 110(1)(*d*) to (*d*.2) and (*f*) and subsection 110.1(1),

(2) Subsection 115(1) of the Act is amended by striking out the word "and" at the end of paragraph (*e*) and adding the following after paragraph (*e*):

(*e*.1) the deduction permitted by subsection (4.1), and

(3) Section 115 of the Act is amended by adding the following after subsection (4):

Foreign resource pool expenses

(4.1) Where a taxpayer ceases at any time after February 27, 2000 to be resident in Canada, a particular taxation year of the taxpayer ends after that time and the taxpayer was non-resident throughout the period (in this subsection referred to as the "non-resident period") that begins at that time and ends at the end of the particular year,

(*a*) in computing the taxpayer's taxable income earned in Canada for the particular year, there may be deducted each amount that would be permitted to be deducted in computing the taxpayer's income for the particular year under subsection 66(4) or 66.21(4) if

(i) subsection 66(4) were read without reference to the words "who is resident throughout a taxation year in Canada" and as if the amount determined under subparagraph 66(4)(*b*)(ii) were nil, and

(ii) subsection 66.21(4) were read without reference to the words "throughout which the taxpayer is resident in Canada" and as if the amounts determined under subparagraph 66.21(4)(*a*)(ii) and paragraph 66.21(4)(*b*) were nil; and

(*b*) an amount deducted under this subsection in computing the taxpayer's taxable income earned in Canada for the particular year is deemed, for the purpose of applying subsection 66(4) or 66.21(4), as the case may be, to a subsequent taxation year, to have been deducted in computing the taxpayer's income for the particular year.

(4) Subsection (1) applies to the 2000 and subsequent taxation years.

(5) Subsections (2) and (3) apply to taxation years that begin after February 27, 2000.

57. (1) Subsections 116(2), (4) and (5) of the Act are amended by replacing the reference to the percentage "33 1/3%" with a reference to the percentage "25%".

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, for a taxation year that ended after February 27, 2000 and before October 18, 2000, the reference in subsections 116(2), (4) and (5) of the Act, as enacted by subsection (1), to the percentage "25%" shall be read as a reference to the percentage "30%".

58. (1) Subsection 117(2) of the Act is replaced by the following:

Rate for 2000

(2) The tax payable under this Part by an individual on the individual's taxable income or taxable income earned in Canada, as the case may be, (in this subdivision referred to as the "amount taxable") for the 2000 taxation year is

(*a*) 17% of the amount taxable, if the amount taxable does not exceed $30,004;

(*b*) $5,101 plus 25% of the amount by which the amount taxable exceeds $30,004, if the amount taxable exceeds $30,004 and does not exceed $60,009; and

(*c*) $12,602 plus 29% of the amount by which the amount taxable exceeds $60,009, if the amount taxable exceeds $60,009.

(2) Subsection 117(2) of the Act, as enacted by subsection (1), is replaced by the following:

Rates for years after 2000

(2) The tax payable under this Part by an individual on the individual's taxable income or taxable income earned in Canada, as the case may be, (in this subdivision referred to as the "amount taxable") for a taxation year is

(*a*) 16% of the amount taxable, if the amount taxable does not exceed $30,754;

(*b*) $4,921 plus 22% of the amount by which the amount taxable exceeds $30,754, if the amount taxable exceeds $30,754 and does not exceed $61,509;

(*b*.1) $11,687 plus 26% of the amount by which the amount taxable exceeds $61,509, if the amount taxable exceeds $61,509 and does not exceed $100,000; and

(*c*) $21,695 plus 29% of the amount by which the amount taxable exceeds $100,000, if the amount taxable exceeds $100,000.

Minimum thresholds for 2004

(3) Each of the amounts of $30,754, $61,509 and $100,000 referred to in subsection (2) is deemed, for the purposes of applying subsection (2) to the 2004 taxation year, to be the greater of

(*a*) the amount that would be used for the 2004 taxation year if this section were read without reference to this subsection; and

(*b*) in the case of

(i) the amount of $30,754, $35,000,

(ii) the amount of $61,509, $70,000, and

(iii) the amount of $100,000, $113,804.

(3) Subsection (1) applies to the 2000 taxation year.

(4) Subsection (2) applies to the 2001 and subsequent taxation years.

59. (1) The portion of paragraph (*c*.1) of the description of B in subsection 118(1) of the Act after clause (iii)(B) is replaced by the following:

the amount determined by the formula

$$\$\underline{15{,}453} - D.1$$

where

D.1 is the greater of $\underline{11,953}$ and the particular person's income for the year,

(2) The portion of paragraph (*d*) of the description of B in subsection 118(1) of the Act after subparagraph (ii) is replaced by the following:

the amount determined by the formula

$$\$\underline{8{,}466} - E$$

where

E is the greater of $\underline{4,966}$ and the dependant's income for the year, and

(3) Subsection 118 of the Act is amended by adding the following after subsection (3):

Minimum amounts for 2004

(3.1) Each of the amounts of $7,131, $6,055 and $606 referred to in paragraphs (*a*) to (*c*) of the description of B in subsection (1) is deemed, for the 2004 taxation year, to be the greater of

(*a*) the amount in respect thereof that would be used for that year if this section were read without reference to this subsection; and

(*b*) in the case of

(i) the amounts of $7,131, $8,000,

(ii) the amounts of $6,055, $6,800, and

(iii) the amounts of $606, $680.

(4) Subsections (1) and (2) apply to the 2001 and subsequent taxation years.

60. (1) The portion of the definition "total ecological gifts" in subsection 118.1(1) of the Act before paragraph (*a*) is replaced by the following:

"total ecological gifts"
« total des dons de biens écosensibles »

"total ecological gifts" of an individual for a taxation year means the total of all amounts each of which is the fair market value of a gift (other than a gift the fair market value of which is included in the total cultural gifts of the individual for the year) of land, including a servitude for the use and benefit of a dominant land, a covenant or an easement, <u>the fair market value of which is certified by the Minister of the Environment and</u> that is certified by <u>that</u> Minister, or a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister, or that person, important to the preservation of Canada's environmental heritage, which gift was made by the individual in the year or in any of the five immediately preceding taxation years to

(2) Subsection 118.1(2) of the Act is replaced by the following:

Proof of gift

(2) A gift shall not be included in the total charitable gifts, total Crown gifts, total cultural gifts or total ecological gifts of an individual unless the making of the gift is proven by filing with the Minister

(<u>*a*</u>) a receipt <u>for the gift</u> that contains prescribed information;

(*b*) in the case of a gift described in the definition "total cultural gifts" in subsection (1), the certificate issued under subsection 33(1) of the *Cultural Property Export and Import Act*; and

(*c*) in the case of a gift described in the definition "total ecological gifts" in subsection (1), both certificates referred to in that definition.

(3) Subsection 118.1(4) of the Act is replaced by the following:

Gift in year of death

(4) Subject to subsection (13), a gift made by an individual in the particular taxation year in which the individual dies (including, for greater certainty, a gift otherwise deemed by subsection (5), (5.2), (5.3), (7), (7.1), (13) or (15) to have been so made) is deemed, for the purpose of this section other than this subsection, to have been made by the individual in the preceding taxation year, and not in the particular year, to the extent that an amount in respect of the gift is not deducted in computing the individual's tax payable under this Part for the particular year.

(4) Section 118.1 of the Act is amended by adding the following after subsection (5):

Direct designation – insurance proceeds

(5.1) Subsection (5.2) applies to an individual in respect of a life insurance policy where

(*a*) the policy is a life insurance policy in Canada under which, immediately before the individual's death, the individual's life was insured;

(*b*) a transfer of money, or a transfer by means of a negotiable instrument, is made as a consequence of the individual's death and solely because of the obligations under the policy, from an insurer to a qualified donee;

(*c*) immediately before the individual's death,

(i) the individual's consent would have been required to change the recipient of the transfer described in paragraph (*b*), and

(ii) the donee was neither a policyholder under the policy, nor an assignee of the individual's interest under the policy; and

(*d*) the transfer occurs within the 36 month period that begins at the time of the death (or, where written application to extend the period has been made to the Minister by the individual's legal representative,

within such longer period as the Minister considers reasonable in the circumstances).

Rules applicable re: subsection (5.1)

(5.2) Where subsection (5.1) applies to an individual in respect of a life insurance policy under which an insurer is obligated to make a transfer,

(*a*) for the purpose of this section (other than subsection (5.1) and this subsection) and paragraph (*b*), the transfer described in subsection (5.1) is deemed to be a gift made, immediately before the individual's death, by the individual to the qualified donee referred to in subsection (5.1); and

(*b*) the fair market value of the gift is deemed to be the fair market value, at the time of the individual's death, of the right to that transfer (determined without reference to any risk of default with regard to obligations of the insurer).

Direct designation – RRSPs and RRIFs

(5.3) Where as a consequence of an individual's death, a transfer of money, or a transfer by means of a negotiable instrument, is made, from a particular trust governed by a registered retirement savings plan or registered retirement income fund to a qualified donee, solely because of the donee's interest as a beneficiary under the particular trust, the individual was the annuitant (within the meaning assigned by subsection 146(1) or 146.3(1)) under the plan or fund immediately before the individual's death and the transfer occurs within the 36 month period that begins at the time of the death (or, where written application to extend the period has been made to the Minister by the individual's legal representative, within such longer period as the Minister considers reasonable in the circumstances),

(*a*) for the purposes of this section (other than this subsection) and paragraph (*b*), the transfer is deemed to be a gift made, immediately before the individual's death, by the individual to the donee; and

(*b*) the fair market value of the gift is deemed to be the fair market value, at the time of the individual's death, of the right to the transfer (determined without reference to any risk of default with regard to the obligations of the trustee of the plan or fund).

(5) Subsection 118.1(10.1) of the Act is replaced by the following:

Determination of fair market value

(10.1) For the purposes of subparagraph 69(1)(*b*)(ii), subsection 70(5) and sections 110.1, 207.31 and this section, where at any time the Canadian Cultural Property Export Review Board or the Minister of the Environment determines or redetermines an amount to be the fair market value of a property that is the subject of a gift described in paragraph 110.1(1)(*a*), or in the definition "total charitable gifts" in subsection (1), made by a taxpayer within the two-year period that begins at that time, an amount equal to the last amount so determined or redetermined within the period is deemed to be the fair market value of the gift at the time the gift was made and, subject to subsections (6), (7), (7.1) and 110.1(3), to be the taxpayer's proceeds of disposition of the gift.

Request for determination by the Minister of the Environment

(10.2) Where a person disposes or proposes to dispose of a property that would, if the disposition were made and the certificates described in paragraph 110.1(1)(*d*) or in the definition "total ecological gifts" in subsection (1) were issued by the Minister of the Environment, be a gift described in those provisions, the person may request, by notice in writing to that Minister, a determination of the fair market value of the property.

Duty of Minister of the Environment

(10.3) In response to a request made under subsection (10.2), the Minister of the Environment shall with all due dispatch make a determination in accordance with subsection (12) or 110.1(5), as the case may be, of the fair market value of the property referred to in that request and give notice of the determination in writing to the person who has disposed of, or who proposes to dispose of, the property, except that no such determination shall be made if the request is received by that Minister after three years after the end of the person's taxation year in which the disposition occurred.

Ecological gifts – redetermination

(10.4) Where the Minister of the Environment has, under subsection 118.1(10.3), notified a person of the amount determined by that Minister to be the fair market value of a property in respect of its disposition or proposed disposition,

(*a*) that Minister shall, on receipt of a written request made by the person on or before the day that is 90 days after the day that the person was so notified of the first such determination, with all due dispatch confirm or redetermine the fair market value;

(*b*) that Minister may, on that Minister's own initiative, at any time redetermine the fair market value;

(*c*) that Minister shall in either case notify the person in writing of that Minister's confirmation or redetermination; and

(*d*) any such redetermination is deemed to replace all preceding determinations and redeterminations of the fair market value of that property from the time at which the first such determination was made.

Certificate of Fair Market Value

(10.5) Where the Minister of the Environment determines under subsection (10.3) the fair market value of a property, or redetermines that value under subsection (10.4), and the property has been disposed of to a qualified donee described in paragraph 110.1(1)(*d*) or in the definition "total ecological gifts" in subsection 118.1(1), that Minister shall issue to the person who made the disposition a certificate that states the fair market value of the property so determined or redetermined and, where more than one certificate has been so issued, the last certificate is deemed to replace all preceding certificates from the time at which the first certificate was issued.

(6) Subsections 118.1(11) and (12) of the Act are replaced by the following:

Assessments

(11) Notwithstanding subsections 152(4) to (5), such assessments or reassessments of a taxpayer's tax, interest or penalties payable under this Act for any taxation year shall be made as are necessary to give effect

(*a*) to a certificate issued under subsection 33(1) of the *Cultural Property Export and Import Act* or to a decision of a court resulting from an appeal made pursuant to section 33.1 of that Act; or

(*b*) to a certificate issued under subsection (10.5) or to a decision of a court resulting from an appeal made pursuant to subsection 169(1.1) of this Act.

Ecological gifts

(12) For the purposes of applying subparagraph 69(1)(*b*)(ii), subsection 70(5), this section and section 207.31 in respect of a gift described in the definition "total ecological gifts" in subsection (1) that is made by an individual, the amount that is the fair market value (or, for the purpose of subsection (6), the fair market value otherwise determined) of the gift at the time the gift was made and, subject to subsection (6), the individual's proceeds of disposition of the gift, is deemed to be the amount determined by the Minister of the Environment to be

(*a*) where the gift is land, the fair market value of the gift or;

(*b*) where the gift is a servitude, covenant or easement to which land is subject, the greater of

(i) the fair market value otherwise determined of the gift, and

(ii) the amount by which the fair market value of the land is reduced as a result of the making of the gift.

(7) Subsections (1), (2), (5) and (6) apply in respect of gifts made, or proposed to be made, after February 27, 2000 except that subsection 118.1(2) of the Act, as enacted by subsection (2), shall be read without reference to paragraph 118.1(2)(*b*) in respect of gifts made before ANNOUNCEMENT DATE.

(8) Subject to subsection (9), subsections (3) and (4) apply in respect of deaths that occur after 1998.

(9) For taxation years before 2000, subsection 118.1(4), as enacted by subsection (3), shall be read without reference to subsections 118.1(7) and (7.1) of the Act except that, where a taxpayer or a taxpayer's legal representative notifies the Minister of National Revenue in writing before July 2001 of the intention of the taxpayer or the taxpayer's legal representative that this subsection apply in respect of a gift made after 1996 and before 2000,

(*a*) subsection 118.1(4) of the Act, as enacted by subsection (3), applies to the taxation year in which the gift was made and, where paragraph 118.1(7)(*d*) of the Act applies, the amount designated in the notice in respect of the gift is deemed to have been validly designated for the purposes of that paragraph in the taxpayer's return of income for the year in which the gift was made; and

(*b*) subsection 118.1(4) of the Act, as enacted by subsection (3), shall be read, in respect of the 1996 to 1998 taxation years, without reference to subsections 118.1(5.2) and (5.3) of the Act.

61. (1) Subsection 118.2(2) of the Act is amended by adding the following after paragraph (*l*.2):

(*l*.21) for reasonable expenses, relating to the construction of the principal place of residence of the patient who lacks normal physical development or has a severe and prolonged mobility impairment, that can reasonably be considered to be incremental costs incurred to enable the patient to gain access to, or to be mobile or functional within, the patient's principal place of residence;

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

62. (1) The portion of subsection 118.3(1) of the French version of the Act before paragraph (*a*) is replaced by the following:

Crédit d'impôt pour déficience mentale ou physique

118.3 (1) Un montant est déductible dans le calcul de l'impôt payable par un particulier en vertu de la présente partie pour une année d'imposition, si les conditions suivantes sont réunies :

(2) Paragraph 118.3(1)(*a*.1) of the Act is replaced by the following:

(*a*.1) the effects of the impairment are such that the individual's ability to perform a basic activity of daily living is markedly restricted or would be markedly restricted but for therapy that

(i) is essential to sustain a vital function of the individual,

(ii) is required to be administered at least three times each week for a total duration averaging not less than 14 hours a week, and

(iii) cannot reasonably be expected to be of significant benefit to persons who are not so impaired,

(3) Paragraph 118.3(1)(*a*.2) of the Act is amended by adding the following after subparagraph (i):

(i.1) a speech impairment, a medical doctor or a speech-language pathologist,

(4) The portion of paragraph 118.3(1)(*a*.2) of the Act after subparagraph (v) is replaced by the following:

has certified in prescribed form that the impairment is a severe and prolonged mental or physical impairment the effects of which are such that the individual's ability to perform a basic activity of daily living is markedly restricted <u>or would be markedly restricted but for therapy referred to in paragraph (*a*.1)</u>,

(5) The portion of subsection 118.3(1) of the Act after paragraph (*c*) is replaced by the following:

there may be deducted <u>in</u> computing the individual's tax payable under this Part for the year <u>the</u> amount determined by the formula

$$A \times (\underline{B + C})$$

where

A is the appropriate percentage for the year,

B is $6,000, and

C is

(*a*) where the individual has not attained the age of 18 years before the end of the year, the amount, if any, by which

(i) $3,500

exceeds

(ii) the amount, if any, by which

(A) the total of all amounts each of which is an amount paid in the year for the care or supervision of the individual and included in computing a deduction under section 63, 64 or 118.2 for a taxation year

exceeds

(B) $2,050, and

(*b*) in any other case, zero.

(6) Clause 118.3(2)(*a*)(i)(B) of the Act is replaced by the following:

(B) paragraph (*c*.1) or (*d*) of that description where the person is a parent, grandparent, child, grandchild, brother, sister, aunt, uncle, nephew or niece of the individual, or of the individual's spouse or common-law partner, or

(7) Subsection 118.3(4) of the Act is replaced by the following:

Additional Information

(4) Where a claim under this section or under section 118.8 is made in respect of an individual's impairment

(*a*) if the Minister requests in writing information with respect to the individual's impairment, its effects on the individual and, where applicable, the therapy referred to in paragraph (1)(*a*.1) that is required to be administered, from any person referred to in subsection (1) or (2) or section 118.8 in connection with such a claim, that person shall provide the information so requested to the Minister in writing; and

(*b*) if the information referred to in paragraph (*a*) is provided by a person referred to in paragraph (1)(*a*.2), the information so provided is deemed to be included in a certificate in prescribed form.

(8) Subsections (1), (2) and (4) to (7) apply to the 2000 and subsequent taxation years except that, in applying subsection (5) to the 2000 taxation year, the references to "$6,000", "$3,500" and "$2050" in the descriptions of B and C in the formula in subsection 118.3(1) of the Act, as enacted by subsection (5), shall be read as references to "$4,293", "$2,941" and "$2,000", respectively.

(9) Subsection (3) applies to certifications made after October 17, 2000.

63. (1) The portion of subsection 118.4(2) of the Act before paragraph (*a*) is replaced by the following:

Reference to medical practitioners, etc.

(2) For the purposes of sections 63, 118.2, 118.3 and 118.6, a reference to an audiologist, dentist, medical doctor, medical practitioner, nurse, occupational therapist, optometrist, pharmacist, psychologist or speech-language pathologist is a reference to a person authorized to practise as such,

(2) Subsection (1) applies to certifications made after October 17, 2000.

64. (1) The portion of subsection 118.6(1) of the Act before the definition "designated educational institution" is replaced by the following:

Definitions

118.6 (1) For the purposes of sections 63 and 64 and this subdivision,

(2) Paragraphs (*a*) and (*b*) of the description of B in subsection 118.6(2) of the Act are replaced by the following:

(*a*) $400 is multiplied by the number of months in the year during which the individual is enrolled in a qualifying educational program as a full-time student at a designated educational institution, and

(*b*) $120 is multiplied by the number of months in the year (other than months described in paragraph (*a*)), each of which is a month during which the individual is enrolled at a designated educational institution in a specified educational program that provides that each student in the program spend not less than 12 hours in the month on courses in the program,

(3) Subsection (1) applies to the 2000 and subsequent taxation years.

(4) Subsection (2) applies to the 2001 and subsequent taxation years.

65. (1) Paragraph (*c*) of the description of B in section 118.7 of the Act is replaced by the following:

(*c*) the amount by which

(i) the total of all amounts each of which is an amount payable by the individual in respect of self-employed earnings for the year as

a contribution under the *Canada Pension Plan* or under a provincial pension plan within the meaning assigned by section 3 of that Act (not exceeding the maximum amount of such contributions payable by the individual for the year under the plan)

exceeds

(ii) the amount deductible under paragraph 60(*e*) in computing the individual's income for the year.

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

66. (1) The portion of subsection 120(1) of the Act before paragraph (*a*) is replaced by the following:

Income not earned in a province

120. (1) There shall be added to the tax otherwise payable under this Part by an individual for a taxation year the amount that bears the same relation to 48% of the tax otherwise payable under this Part by the individual for the year that

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

67. (1) Paragraph (*b*) of the description of A in subsection 122.51(2) of the Act is amended by replacing the reference to the fraction "25/17" with a reference to the fraction "25/16".

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

68. (1) The portion of the description of B in subsection 122.61(1) of the Act before paragraph (*a*) is replaced by the following:

B is 4% (or where the person is an eligible individual in respect of only one qualified dependant at the beginning of the month, 2%) of the amount, if any, by which

(2) Paragraph (*b*) of the description of B in subsection 122.61(1) of the Act is replaced by the following:

(*b*) the greater of $32,000 and the dollar amount, as adjusted annually and referred to in paragraph 117(2)(*a*),

that is used for the calendar year following the base taxation year; and

(3) Paragraphs (*a*) and (*b*) of the description of F in subsection 122.61(1) of the Act are replaced by the following:

(*a*) only one qualified dependant, $1,255, and

(*b*) two or more qualified dependants, the total of

(i) $1,255 for the first qualified dependant,

(ii) $1055 for the second qualified dependant, and

(iii) $980 for each of the third and subsequent qualified dependants,

(4) Subsection (1) applies with respect to overpayments deemed to arise during months that are after June 2004.

(5) Subsections (2) and (3) apply with respect to overpayments deemed to arise during months that are after June 2001.

69. (1) Paragraph 123.2(*a*) of the Act is replaced by the following:

(*a*) the tax payable under this Part by the corporation for the year determined without reference to this section, sections 123.3, 123.4 and 125 to 126 and subsections 127(3), (5), (27) to (31), (34) and (35) and 137(3) and as if subsection 124(1) did not contain the words "in a province"

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

70. (1) The Act is amended by adding the following after section 123.3:

Corporation Tax Reductions

Definitions

123.4 (1) The definitions in this subsection apply in this section.

"CCPC rate reduction percentage"
« pourcentage de réduction du taux des SPCC »

"CCPC rate reduction percentage" of a Canadian-controlled private corporation for a taxation year is that proportion of 7% that the number of days in the year that are after 2000 is of the number of days in the year.

"full rate taxable income"
« revenu imposable au taux complet »

"full rate taxable income" of a corporation for a taxation year is

(*a*) if the corporation is not a corporation described in paragraph (*b*) or (*c*) for the year, the amount by which the corporation's taxable income for the year exceeds the total of,

(i) if an amount is deducted under subsection 125.1(1) from the corporation's tax otherwise payable under this Part for the year, 100/7 of the amount deducted,

(ii) if an amount is deducted under subsection 125.1(2) from the corporation's tax otherwise payable under this Part for the year, the amount determined, in respect of the deduction, by the formula in that subsection,

(iii) three times the total of all amounts each of which is deducted under paragraph 20(1)(*v*.1) in computing the corporation's income from a business or property for the year, and

(iv) if the corporation is a credit union throughout the year, 100/16 of the amount, if any, deducted under subsection 137(3) from the corporation's tax otherwise payable under this Part for the year;

(*b*) if the corporation is a Canadian-controlled private corporation throughout the year, the amount by which the corporation's taxable income for the year exceeds the total of

(i) the amounts that would, if paragraph (*a*) applied to the corporation, be determined under subparagraphs (*a*)(i) to (iv) in respect of the corporation for the year,

(ii) 100/16 of the amount, if any, deducted under subsection 125(1) from the corporation's tax otherwise payable under this Part for the year,

(iii) the corporation's aggregate investment income for the year, within the meaning assigned by subsection 129(4), and

(iv) 100/7 of the amount, if any, deducted under subsection (3) from the corporation's tax otherwise payable under this Part for the year; and

(*c*) if the corporation is throughout the year an investment corporation, a mortgage investment corporation, a mutual fund corporation, or a non-resident-owned investment corporation, nil.

"general rate reduction percentage"
« pourcentage de réduction du taux général »

"general rate reduction percentage" of a corporation for a taxation year is the total of

(*a*) that proportion of 1% that the number of days in the year that are in 2001 is of the number of days in the year;

(*b*) that proportion of 3% that the number of days in the year that are in 2002 is of the number of days in the year;

(*c*) that proportion of 5% that the number of days in the year that are in 2003 is of the number of days in the year; and

(*d*) that proportion of 7% that the number of days in the year that are after 2003 is of the number of days in the year.

General deduction from tax

(2) There may be deducted from a corporation's tax otherwise payable under this Part for a taxation year the product obtained by

multiplying the corporation's general rate reduction percentage for the year by the corporation's full-rate taxable income for the year.

CCPC deduction

(3) There may be deducted from the tax otherwise payable under this Part for a taxation year by a Canadian-controlled private corporation the product obtained by multiplying the corporation's CCPC rate reduction percentage for the year by the amount by which the least of

(*a*) 3/2 of the corporation's business limit for the year, as determined under section 125 for the purpose of paragraph 125(1)(*c*),

(*b*) the amount that would be determined under paragraph 125(1)(*a*) in respect of the corporation for the year if the references in the description of M in the definition "specified partnership income" in subsection 125(7) to "$200,000" and "$548" were read as references to "$300,000" and "$822", respectively, and

(*c*) the amount by which the amount determined under paragraph 125(1)(*b*) in respect of the corporation for the year exceeds the corporation's aggregate investment income determined under subsection 129(4) for the year

exceeds the total of

(*d*) the amounts that would, if paragraph (*a*) of the definition "full-rate taxable income" in subsection (1) applied to the corporation for the year, be determined under subparagraphs (*a*)(i) to (iv) of that definition in respect of the corporation for the year, and

(*e*) 100/16 of the amount, if any, deducted under subsection 125(1) from the corporation's tax otherwise payable under this Part for the year.

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

71. (1) The portion of subsection 125.1(2) of the Act before the formula is replaced by the following:

Electrical energy and steam

(2) A corporation that generates electrical energy for sale, or produces steam <u>for sale</u>, in a taxation year may deduct from its tax otherwise payable under this Part for the year 7% of the amount determined by the formula

(2) Paragraphs 125.1(5)(*a*) and (*b*) of the Act are replaced by the following:

(*a*) electrical energy, <u>and steam, are</u> deemed to be <u>goods</u>; and

(*b*) the generation of electrical energy for sale, <u>and the production of steam for sale, are</u> deemed to be, subject to paragraph (*l*) of the definition "manufacturing or processing" in subsection (3), manufacturing or processing.

(3) Subsections (1) and (2) apply to taxation years that end after 1999 except that, in its application to such a taxation year that begins before 2002, the reference to "7%" in subsection 125.1(2) of the Act, as enacted by subsection (1), shall be read as a reference to the total of

(*a*) 0% multiplied by the number of days in the year that are before 1999,

(*b*) in the case of a corporation that in 1999 generated electrical energy for sale, or produced steam for use in the generation of electrical energy for sale, that proportion of 1% that the number of days in the taxation year that are in the 1999 calendar year is of the number of days in the taxation year,

(*c*) in the case of a corporation to which paragraph (*b*) does not apply, 0% multiplied by the number of days in the taxation year that are in the 1999 calendar year,

(*d*) that proportion of 3% that the number of days in the taxation year that are in the 2000 calendar year is of the number of days in the taxation year,

(*e*) that proportion of 5% that the number of days in the taxation year that are in the 2001 calendar year is of the number of days in the taxation year,

(*f*) that proportion of 7% that the number of days in the taxation year that are in the 2002 calendar year is of the number of days in the taxation year, and

(*g*) that proportion of 7% that the number of days in the taxation year that are in the 2003 calendar year is of the number of days in the taxation year.

72. (1) Paragraphs 126(2.3)(*b*) and (*c*) of the Act are replaced by the following:

(*b*) no amount may be claimed under paragraph (2)(*a*) in computing a taxpayer's tax payable under this Part for a particular taxation year in respect of the taxpayer's unused foreign tax credit in respect of a country for a taxation year until the taxpayer's unused foreign tax credits in respect of that country for taxation years preceding the taxation year that may be claimed for the particular taxation year have been claimed; and

(*c*) an amount in respect of a taxpayer's unused foreign tax credit in respect of a country for a taxation year may be claimed under paragraph (2)(*a*) in computing the taxpayer's tax payable under this Part for a particular taxation year only to the extent that it exceeds the aggregate of all amounts each of which is the amount that may reasonably be considered to have been claimed in respect of that unused foreign tax credit in computing the taxpayer's tax payable under this Part for a taxation year preceding the particular taxation year.

(2) Subsection 126(5) of the Act is replaced by the following:

Foreign oil and gas levies

(5) A taxpayer who is resident in Canada throughout a taxation year and carries on a foreign oil and gas business in a taxing country in the year is deemed for the purposes of this section to have paid in the year as an income or profits tax to the government of the taxing country an amount equal to the lesser of

(*a*) the amount, if any, by which

(i) 40% of the taxpayer's income from the business in the taxing country for the year

exceeds

(ii) the total of all amounts that would, but for this subsection, be income or profits taxes paid in the year in respect of the business to the government of the taxing country, and

(*b*) the taxpayer's production tax amount for the business in the taxing country for the year.

(3) The definition "qualifying incomes" in subsection 126(7) of the Act is replaced by the following:

"qualifying incomes"
« revenus admissibles »

"qualifying incomes" of a taxpayer from sources in a country means incomes from sources in the country, determined in accordance with subsection (9);

(4) The definition "qualifying losses" in subsection 126(7) of the Act is replaced by the following:

"qualifying losses"
« pertes admissibles »

"qualifying losses" of a taxpayer from sources in a country means losses from sources in the country, determined in accordance with subsection (9);

(5) The definition "unused foreign tax credit" in subsection 126(7) of the Act is replaced by the following:

"unused foreign tax credit"
« fraction inutilisée du crédit pour impot étranger »

"unused foreign tax credit" of a taxpayer in respect of a country for a taxation year means the amount, if any, by which

(*a*) the business-income tax paid by the taxpayer for the year in respect of businesses carried on by the taxpayer in that country

exceeds

(*b*) the amount, if any, deductible under subsection (2) in respect of that country in computing the taxpayer's tax payable under this Part for the year.

(6) Subsection 126(7) of the Act is amended by adding the following in alphabetical order:

"commercial obligation"
« obligation commerciale »

"commercial obligation" in respect of a taxpayer's foreign oil and gas business in a country means an obligation of the taxpayer to a particular person, undertaken in the course of carrying on the business or in contemplation of the business, if the law of the country would have allowed the taxpayer to undertake an obligation, on substantially the same terms, to a person other than the particular person;

"foreign oil and gas business"
« entreprise pétrolière et gazière à l'étranger »

"foreign oil and gas business" of a taxpayer means a business, carried on by the taxpayer in a taxing country, the principal activity of which is the extraction from natural accumulations, or from oil or gas wells, of petroleum, natural gas or related hydrocarbons;

"production tax amount"
« impôt sur la production »

"production tax amount" of a taxpayer for a foreign oil and gas business carried on by the taxpayer in a taxing country for a taxation year means the total of all amounts each of which

(*a*) became receivable in the year by the government of the country because of an obligation (other than a commercial obligation) of the taxpayer, in respect of the business, to the government or an agent or instrumentality of the government,

(*b*) is computed by reference to the amount by which

(i) the amount or value of petroleum, natural gas or related hydrocarbons produced or extracted by the taxpayer in the course of carrying on the business in the year

exceeds

(ii) an allowance or other deduction that

(A) is deductible, under the agreement or law that creates the obligation described in paragraph (*a*), in computing the amount receivable by the government of the country, and

(B) is intended to take into account the taxpayer's operating and capital costs of that production or extraction, and can reasonably be considered to have that effect,

(*c*) would not, if this Act were read without reference to subsection (5), be an income or profits tax, and

(*d*) is not identified as a royalty under the agreement that creates the obligation or under any law of the country;

"taxing country"
« pays taxateur »

"taxing country" means a country (other than Canada) the government of which regularly imposes, in respect of income from businesses carried on in the country, a levy or charge of general application that would, if this Act were read without reference to subsection (5), be an income or profits tax.

(7) Section 126 of the Act is amended by adding the following after subsection (8):

Computation of qualifying incomes and losses

(9) The qualifying incomes and qualifying losses for a taxation year of a taxpayer from sources in a country shall be determined

(*a*) without reference to

(i) any portion of income that was deductible under subparagraph 110(1)(*f*)(i) in computing the taxpayer's taxable income,

(ii) for the purpose of subparagraph 126(1)(*b*)(i), any portion of income in respect of which an amount was deducted under section 110.6 in computing the taxpayer's income,

(iii) any income or loss from a source in the country if any income of the taxpayer from the source would be tax-exempt income; and

(*b*) as if the total of all amounts each of which is that portion of an amount deducted under subsection 66(4), 66.21(4), 66.7(2) or 66.7(2.3) in computing those qualifying incomes and qualifying losses for the year that applies to those sources were the greater of

(i) the total of all amounts each of which is that portion of an amount deducted under subsection 66(4), 66.21(4), 66.7(2) or 66.7(2.3) in computing the taxpayer's income for the year that applies to those sources, and

(ii) the total of

(A) the portion of the maximum amount that would be deductible under subsection 66(4) in computing the taxpayer's income for the year that applies to those sources if the amount determined under subparagraph 66(4)(*b*)(ii) for the taxpayer in respect of the year were equal to the amount, if any, by which the total of

(I) the taxpayer's foreign resource income (within the meaning assigned by subsection 66.21(1)) for the year in respect of the country, determined as if the taxpayer had claimed the maximum amounts deductible for the year under subsections 66.7(2) and (2.3), and

(II) all amounts each of which would have been an amount included in computing the taxpayer's income for the year under subsection 59(1) in respect of a disposition of a foreign resource property in respect of the country, determined as if each amount determined under subparagraph 59(1)(*b*)(ii) were nil,

exceeds

(III) the total of all amounts each of which is a portion of an amount (other than a portion that results in a reduction of the amount otherwise determined under subclause (I)) that applies to those sources and that would be deducted under subsection 66.7(2) in computing the taxpayer's income for the year if the maximum amounts deductible for the year under that subsection were deducted,

(B) the maximum amount that would be deductible under subsection 66.21(4) in respect of those sources in computing the taxpayer's income for the year if

(I) the amount deducted under subsection 66(4) in respect of those sources in computing the taxpayer's income for the year were the amount determined under clause (A),

(II) the amounts deducted under subsections 66.7(2) and (2.3) in respect of those sources in computing the taxpayer's income for the year were the maximum amounts deductible under those subsections,

(III) for the purposes of the definition "cumulative foreign resource expense" in subsection 66.21(1), the total of the amounts designated under subparagraph 59(1)(*b*)(ii) for the year in respect of dispositions by the taxpayer of foreign resource properties in respect of the country in the year were the maximum total that could be so designated without any reduction in the maximum amount that would be determined under clause (A) in respect of the taxpayer for the year in respect of the country if no assumption had been made under subclause (A)(II) in respect of designations made under subparagraph 59(1)(*b*)(ii), and

(IV) the amount determined under paragraph 66.21(4)(*b*) were nil, and

(C) the total of all amounts each of which is the maximum amount, applicable to one of those sources, that is deductible under subsection 66.7(2) or (2.3) in computing the taxpayer's income for the year.

(8) Subsections (1) and (5) apply to the 2001 and subsequent taxation years.

(9) Subsections (2) to (4), (6) and (7) apply to taxation years of a taxpayer that begin after the earlier of

(*a*) December 31, 1999; and

(*b*) where, for the purposes of this subsection, a date is designated in writing by the taxpayer and the designation is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act receives royal assent, the later of

(i) the date so designated, and

(ii) December 31, 1994.

73. (1) Subparagraph 127(5)(*a*)(i) of the Act is replaced by the following:

(*i*) the taxpayer's investment tax credit at the end of the year in respect of property acquired before the end of the year, of the taxpayer's flow-through mining expenditure for the year or a preceding taxation year or of the taxpayer's SR&ED qualified expenditure pool at the end of the year or of a preceding taxation year, and

(2) Clause 127(5)(*a*)(ii)(A) of the Act is replaced by the following:

(A) the taxpayer's investment tax credit at the end of the year in respect of property acquired in a subsequent taxation year, of the taxpayer's flow-through mining expenditure for a subsequent taxation year or of the taxpayer's SR&ED qualified expenditure pool at the end of a subsequent taxation year to the extent that an investment tax credit was not deductible under this subsection for the subsequent year, and

(3) Paragraph 127(5)(*b*) of the Act is replaced by the following:

(*b*) where Division E.1 applies to the taxpayer for the year, the amount, if any, by which

(i) the taxpayer's tax otherwise payable under this Part for the year

exceeds

(ii) the taxpayer's minimum amount for the year determined under section 127.51.

(4) Paragraph (*a*.1) of the definition "investment tax credit" in subsection 127(9) of the Act is replaced by the following:

(*a*.1) 20% of the amount by which the taxpayer's SR&ED qualified expenditure pool at the end of the year exceeds the total of all amounts each of which is the super-allowance benefit amount for the year in respect of the taxpayer in respect of a province,

(*a*.2) where the taxpayer is an individual (other than a trust), 15% of the taxpayer's flow-through mining expenditures for the year,

(5) Paragraph (*c*) of the definition "investment tax credit" in subsection 127(9) of the Act is replaced by the following:

(*c*) the total of all amounts each of which is an amount determined under paragraph (*a*), (*a*.1), (*a*.2) or (*b*) in respect of the taxpayer for any of the 10 taxation years immediately preceding or the 3 taxation years immediately following the year,

(6) Subsection 127(9) of the Act is amended by adding the following in alphabetical order:

"flow-through mining expenditure"
« dépense minière déterminée »

"flow-through mining expenditure" of a taxpayer for a taxation year means an expense deemed by subsection 66(12.61) (or by subsection 66(18) as a consequence of the application of subsection 66(12.61) to the partnership, referred to in paragraph (*c*) of this definition, of which the taxpayer is a member) to be incurred by the taxpayer in the year

(*a*) that is a Canadian exploration expense incurred after October 17, 2000 and before 2004 by a corporation in conducting mining exploration activity from or above the surface of the earth for the purpose of determining the existence or location of a mineral resource described in paragraph (*a*) or (*d*) of the definition "mineral resource" in subsection 248(1),

(*b*) that would be described in paragraph (*f*) of the definition "Canadian exploration expense" in subsection 66.1(6) if that paragraph were read to exclude expenses in respect of digging test pits and preliminary sampling,

(*c*) an amount in respect of which is renounced in accordance with subsection 66(12.6) by the corporation to the taxpayer (or a partnership of which the taxpayer is a member) under an agreement described in that subsection and made after October 17, 2000,

(*d*) that is not an expense that was renounced under subsection 66(12.6) to the corporation (or a partnership of which the corporation is a member), unless that renunciation was under an

agreement described in that subsection and made after October 17, 2000, and

(*e*) that is an expense that would be incurred by the corporation before 2004 if this Act were read without reference to subsection 66(12.66);

"super-allowance benefit amount"
« avantage relatif à la superdéduction »

"super-allowance benefit amount" for a particular taxation year in respect of a corporation in respect of a province means the amount determined by the formula

$$(A - B) \times C$$

where

A is the total of all amounts each of which is an amount that is or may become deductible by the corporation, in computing income or taxable income relevant in calculating an income tax payable by the corporation under a law of the province for any taxation year, in respect of an expenditure on scientific research and experimental development incurred in the particular year,

B is the amount by which the amount of the expenditure exceeds the total of all amounts that would be required by subsections (18) to (20) to reduce the corporation's qualified expenditures otherwise determined under this section if the definitions "government assistance" and "non-government assistance" did not apply to assistance provided under that law,

C is,

(*a*) where the corporation's expenditure limit for the particular year is nil, the maximum rate of the province's income tax that applies for that year to active business income earned in the province by a corporation, and

(*b*) in any other case, the rate of the province's income tax for that year that would apply to the corporation if

(i) it were not associated with any other corporation in the year,

(ii) its taxable income for the year were less than $200,000, and

(iii) its taxable income for the year were earned in the province in respect of an active business carried on in the province;

(7) Paragraph 127(10.1)(*b*) is replaced by the following:

(*b*) the amount by which the corporation's SR&ED qualified expenditure pool at the end of the year exceeds the total of all amounts each of which is the super-allowance benefit amount for the year in respect of the corporation in respect of a province; and

(8) Subsection 127(11.1) of the Act is amended by striking out the word "and" at the end of paragraph (*c*.1) and adding the following paragraph after paragraph (*c*.1):

(*c*.2) the amount of a taxpayer's flow-through mining expenditure for a taxation year is deemed to be the amount of the taxpayer's flow-through mining expenditure for the year as otherwise determined less the amount of any government assistance or non-government assistance in respect of expenses included in determining the taxpayer's flow-through mining expenditure for the year that, at the time of the filing of the taxpayer's return of income for the year, the taxpayer has received, is entitled to receive or can reasonably be expected to receive; and

(9) Subsections (1) and (2) apply to the 2000 and subsequent taxation years, except that, for the 2000 taxation year, clause 127(5)(*a*)(ii)(A) of the Act, as enacted by subsection (2), shall be read as follows:

"(A) the taxpayer's investment tax credit at the end of the year in respect of property acquired in a subsequent taxation year, of the taxpayer's flow-through mining expenditure for a subsequent taxation year or of the taxpayer's SR&ED qualified expenditure pool at the end of a subsequent taxation year to the extent that an investment tax credit was not deductible under this subsection or subsection 180.1(1.2) for the subsequent year, and"

(10) Subsection (3) applies to the 2001 and subsequent taxation years.

(11) Paragraph (*a*.1) of the definition "investment tax credit" in subsection 127(9) of the Act, as enacted by subsection (4), the definition "super-allowance benefit amount", as enacted by

subsection (6), and subsection (7) apply to taxation years that begin after February 2000 except that, if a corporation's first taxation year that begins after February 2000 ends before 2001, those provisions apply to the corporation's taxation years that begin after 2000.

(12) Paragraph (*a*.2) of the definition "investment tax credit" in subsection 127(9) of the Act, as enacted by subsection (4), subsection (5) and the definition "flow-through mining expenditure", as enacted by subsection (6), apply after October 17, 2000.

(13) Subsection (8) applies to the 2000 and subsequent taxation years.

74. (1) Subparagraph 127.52(1)(*d*)(i) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(2) Subparagraph 127.52(1)(*d*)(ii) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(3) The portion of paragraph 127.52(1)(*e*) of the Act before subparagraph (i) is replaced by the following:

(*e*) the total of all amounts deductible under section 65, 66, 66.1, 66.2, <u>66.21</u> or 66.4 or under subsection 29(10) or (12) of the *Income Tax Application Rules* in computing the individual's income for the year were the lesser of the amounts otherwise so deductible by the individual for the year and the total of

(4) Subparagraph 127.52(1)(*e*.1)(ii) of the Act is replaced by the following:

(ii) the total of all amounts each of which is an amount deductible under section 65, 66, 66.1, 66.2, <u>66.21</u> or 66.4 or under subsection 29(10) or (12) of the *Income Tax Application Rules* in computing the individual's income for the year;

(5) Subparagraph 127.52(1)(*g*)(ii) of the Act is amended by replacing the reference to the fraction "1/3" with a reference to the fraction "1/2".

(6) Subsections (1) and (2) apply to taxation years that end after February 27, 2000 except that, for a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000,

(*a*) the reference to the fraction "1/2" in subparagraph 127.52(1)(*d*)(i) of the Act, as enacted by subsection (1), shall be read as reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year; and

(*b*) the reference to the word "twice" in subparagraph 127.52(1)(*d*)(ii) of the Act, as enacted by subsection (2), shall be read as reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year, multiplied by".

(7) Subsections (3) and (4) apply to taxation years that begin after 2000.

(8) Subsection (5) applies to taxation years that end after February 27, 2000 except that, for a taxation year of a trust that includes either February 28, 2000 or October 17, 2000, the reference to the expression "1/2 of" in subparagraph 127.52(1)(*g*)(ii) of the Act, as enacted by subsection (5), shall be read as a reference to the expression "the fraction that is equal to the amount obtained when 1 is subtracted from the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the trust for that year, multiplied by".

75. (1) Clause 128(2)(*e*)(ii)(A) of the Act is replaced by the following:

(A) an amount under any of paragraphs 110(1)(*d*) to (*d*.3) and section 110.6 to the extent that the amount is in respect of an amount included in income under subparagraph (i) for that taxation year, and

(2) Subparagraph 128(2)(*f*)(iii) of the Act is replaced by the following:

(iii) in computing the individual's taxable income for the year, no amount were deductible under any of paragraphs 110(1)(*d*) to (*d*.3) and section 110.6 in respect of an amount included in income under subparagraph (*e*)(i), and no amount were deductible under section 111, and

(3) Subsections (1) and (2) apply to the 2000 and subsequent taxation years.

76. (1) Subparagraph 130.1(1)(*a*)(ii) of the Act is amended by replacing the reference to the fraction "3/4" with a reference to the fraction "1/2".

(2) Subparagraph 130.1(4)(*a*)(i) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(3) Section 130.1 of the Act is amended by adding the following after subsection 130.1(4.1)

Reporting

(4.2) Where subparagraph (4)(*a*)(i) or (ii) applies to a dividend paid by a mortgage investment corporation to a shareholder of any class of shares of its capital stock, the corporation shall disclose to the shareholder in prescribed form the amount of the dividend that is in respect of capital gains realized on dispositions of property that occurred

(*a*) before February 28, 2000,

(*b*) after February 27, 2000 and before October 18, 2000, and

(*c*) after October 17, 2000

and, if it does not do so, the dividend is deemed to be in respect of capital gains realized on dispositions of property that occurred before February 28, 2000.

Allocation

(4.3) Where subsection (4) applies in respect of a dividend paid by a mortgage investment corporation in the period commencing 90 days after the beginning of the corporation's taxation year that includes either February 28, 2000 or October 17, 2000 and ending 90 days after the end of that year, and the corporation so elects under this subsection in its return of income for the year, the following rules apply:

(*a*) the portion of the dividend that is in respect of capital gains realized on dispositions of property that occurred in the year and before February 28, 2000 is deemed to equal that proportion of the dividend that the number of days that are in that year and before February 28, 2000 is of the number of days that are in that year;

(*b*) the portion of the dividend that is in respect of capital gains realized on dispositions of property that occurred in the year and in the period that began at the beginning of February 28, 2000 and ended at the end of October 17, 2000 is deemed to equal that

proportion of the dividend that the number of days that are in the year and in that period is of the number of days that are in the year; and

(*c*) the portion of the dividend that is in respect of capital gains realized on dispositions of property that occurred in the year and in the period that begins at the beginning of October 18, 2000 and ends at the end of the year, is deemed to equal that proportion of the dividend that the number of days that are in the year and in that period is of the number of days that are in the year.

(4) Subsections (1) to (3) apply to taxation years that end after February 27, 2000 except that, for a corporation's taxation year that includes either February 28, 2000 or October 17, 2000,

(*a*) the reference to the fraction "1/2" in subparagraph 130.1(1)(*a*)(ii) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the corporation for the year; and

(*b*) the reference to the word "twice" in subparagraph 130.1(4)(*a*)(i) of the Act, as enacted by subsection (2), shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the corporation for the year, multiplied by".

77. (1) Paragraph 131(1)(*b*) of the Act is replaced by the following:

(*b*) notwithstanding any other provision of this Act, any amount received by a taxpayer in a taxation year as, on account of, in lieu of payment of or in satisfaction of, the dividend shall not be included in computing the taxpayer's income for the year as income from a share of the capital stock of the corporation, and

(i) where the dividend was in respect of capital gains of the corporation from dispositions of property that occurred before February 28, 2000, and the taxation year of the taxpayer began after February 27, 2000 and ended before October 18, 2000, 9/8 of the dividend is deemed to be a capital gain of the taxpayer from the disposition by the taxpayer of a capital property in the year,

(ii) where the dividend was in respect of capital gains of the corporation from dispositions of property that occurred before February 28, 2000, and the taxation year of the taxpayer includes

February 27, 2000, the dividend is deemed to be a capital gain of the taxpayer from the disposition by the taxpayer of a capital property in the year and before February 28, 2000,

(iii) where the dividend was in respect of capital gains of the corporation from dispositions of property that occurred after February 27, 2000 and before October 18, 2000, and the taxation year of the taxpayer began after October 17, 2000, 4/3 of the dividend is deemed to be a capital gain of the taxpayer from the disposition by the taxpayer of a capital property in the year,

(iv) where the dividend was in respect of capital gains of the corporation from dispositions of property that occurred after February 27, 2000 and before October 18, 2000, and the taxation year of the taxpayer includes October 17, 2000, the dividend is deemed to be a capital gain of the taxpayer from the disposition by the taxpayer of a capital property in the year and before October 18, 2000, and

(v) in any other case, the dividend is deemed to be a capital gain of the taxpayer from the disposition of capital property after October 17, 2000 and in the year.

(2) Section 131 of the Act is amended by adding the following after subsection 131(1.4):

Reporting

(1.5) Where subparagraph (1)(*b*)(i) to (iv) applies to a dividend paid by a mutual fund corporation to a shareholder of any class of shares of its capital stock, the corporation shall disclose to the shareholder in prescribed form the amount of the dividend that is in respect of capital gains realized on dispositions of property that occurred before February 28, 2000, after February 27, 2000 and before October 18, 2000, and after October 17, 2000, and, if it does not do so, the dividend is deemed to be in respect of capital gains realized on dispositions of property that occurred before February 28, 2000.

Allocation

(1.6) Where subsection (1) applies in respect of a dividend paid by a mutual fund corporation in the period commencing 60 days after the beginning of the corporation's taxation year that includes either February 28, 2000 or October 17, 2000 and ending 60 days after the end of that year, and the corporation so elects under this paragraph in its return of income

(*a*) the portion of the dividend that is in respect of capital gains realized on dispositions of property that occurred in the year and before February 28, 2000 is deemed to equal that proportion of the dividend that the number of days that are in that year and before February 28, 2000 is of the number of days that are in that year;

(*b*) the portion of the dividend that is in respect of capital gains realized on dispositions of property that occurred in the year and in the period that began at the beginning of February 28, 2000 and ended at the end of October 17, 2000 is deemed to equal that proportion of the dividend that the number of days that are in the year and in that period is of the number of days that are in the year; and

(*c*) the portion of the dividend that is in respect of capital gains realized on dispositions of property that occurred in the year and in the period that begins at the beginning of October 18, 2000 and ends at the end of the year, is deemed to equal that proportion of the dividend that the number of days that are in the year and in that period is of the number of days that are in the year.

(3) Paragraph 131(2)(*a*) of the Act is replaced by the following:

(*a*) may, on <u>sending</u> the notice of assessment for the year, refund an amount (in this <u>subsection</u> referred to as its "capital gains refund" for the year) equal to the lesser of

(i) the total of

(A) <u>14% of the total of</u>

<u>(I)</u> all capital gains dividends paid by the corporation in the period commencing 60 days after the <u>beginning</u> of the year and ending 60 days after the end of the year, and

<u>(II)</u> its capital gains redemptions for the year, and

(B) the amount, if any, that the Minister determines to be reasonable in the circumstances, after giving consideration to the percentages applicable in determining the corporation's capital gains refund for the year and preceding taxation years and the percentages applicable in determining the corporation's refundable capital gains tax on hand at the end of the year, and

(ii) the corporation's refundable capital gains tax on hand at the end of the year; and

(4) Subparagraph (*b*)(iii) of the definition "capital gains dividend account" in subsection 131(6) of the Act is replaced by the following:

(iii) the total of all amounts each of which is

(A) an amount equal to 100/21 of its capital gains refund for any taxation year throughout which it was a mutual fund corporation where the year ended

(I) more than 60 days before that time, and

(II) before February 28, 2000,

(B) an amount equal to 100/18.7 of its capital gains refund for any taxation year throughout which it was a mutual fund corporation where the year ended

(I) more than 60 days before that time, and

(II) after February 27, 2000 and before October 18, 2000, or

(C) an amount equal to 100/14 of its capital gain refund for any taxation year throughout which it was a mutual fund corporation where the year ended

(I) more than 60 days before that time, and

(II) after October 17, 2000;

(5) The description of C in the definition "capital gains redemptions" in subsection 131(6) of the Act is amended by replacing the reference to the fraction "100/21" with a reference to the fraction "100/14".

(6) Subsections (1) to (5) apply to taxation years that end after February 27, 2000 except that, for a taxation year of a mutual fund corporation that includes either February 28, 2000 or October 17, 2000,

(*a*) the reference to the percentage "14%" in clause 131(2)(*a*)(i)(A) of the Act, as enacted by subsection (3), shall be read as a reference to the percentage determined when 28% is multiplied by the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the corporation for the year;

(*b*) the reference to the fraction "100/18.7" in clause (*b*)(iii)(B) of the definition "capital gains dividend account" in subsection 131(6) of the Act, as enacted by subsection (4), shall be read as a reference to the fraction "100/28X", where "X" is the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the corporation for the year; and

(*c*) the reference to the fraction "100/14" in the description of C in the definition "capital gains redemptions" in subsection 131(6) of the Act, as enacted by subsection (5), shall be read as a reference to the fraction "100/28X", where "X" is the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the corporation for the year.

78. (1) Subparagraph 132(1)(*a*) of the Act is replaced by the following:

(*a*) may, on sending the notice of assessment for the year, refund an amount (in this subsection referred to as its "capital gains refund" for the year) equal to the lesser of

(i) the total of

(A) 14.5% of the total of the trust's capital gains redemptions for the year,

(B) the amount, if any, that the Minister determines to be reasonable in the circumstances, after giving consideration to the percentages applicable in determining the trust's capital gains refunds for the year and preceding taxation years and the percentages applicable in determining the trust's refundable capital gains tax on hand at the end of the year, and

(ii) the trust's refundable capital gains tax on hand at the end of the year; and

(2) The first formula in the definition "capital gains redemptions" in subsection 132(4) of the Act is replaced by the following:

$$(A/B \times (C + D)) \underline{- E}$$

(3) The description of A in the definition "capital gains redemptions" in subsection 132(4) of the Act is replaced by the following:

A is the total of all amounts each of which is a portion of an amount paid by the trust in the year on the redemption of a unit in the trust

that is included in the proceeds of disposition in respect of that redemption,

(4) The description of C in the definition "capital gains redemptions" in subsection 132(4) of the Act is amended by replacing the reference to the fraction "100/21.75" with a reference to the fraction "100/14.5".

(5) The definition "capital gains redemptions" in subsection 132(4) of the Act is amended by striking out the word "and" at the end of the description of C, by adding the word "and" at the end of the description of D and by adding the following after that description:

E is twice the total of all amounts each of which is an amount designated under subsection 104(21) for the year by the trust in respect of a unit of the trust redeemed by the trust at any time in the year and after **ANNOUNCEMENT DATE**;

(6) Subsections (1) to (5) apply to taxation years that end after February 27, 2000 except that, for a taxation year of a mutual fund trust that includes either February 28, 2000 or October 17, 2000,

(*a*) the reference to the percentage "14.5%" in subparagraph 132(1)(*a*) of the Act, as enacted by subsection (1), shall be read as a reference to the percentage determined when 29% is multiplied by the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the trust for the year;

(*b*) the reference to the fraction "100/14.5" in the description of C in the definition "capital gains redemptions" in subsection 132(4) of the Act, as enacted by subsection (4), shall be read as a reference to the fraction "100/29X", where "X" is the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the trust for the year; and

(*c*) the reference to the word "twice" in the description of E in the definition "capital gains redemption" in subsection 132(4) of the Act, as enacted by subsection (5), shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year, multiplied by".

79. (1) Paragraph 133(1)(*d*) of the Act is amended by replacing the reference to the expression "4/3 of" with a reference to the word "twice".

(2) The portion of the definition "non-resident-owned investment corporation" in subsection 133(8) of the Act after paragraph (*d*) is replaced by the following:

(*e*) it has, <u>on or before the earlier of February 27, 2000 and the day that is</u> 90 days after the <u>beginning</u> of its first taxation year <u>that begins</u> after 1971, elected in prescribed manner to be taxed under this section, and

(*f*) it has not, before the end of the last taxation year in the period, revoked in prescribed manner <u>its</u> election,

except that

(*g*) a new corporation (within the meaning assigned by section 87) formed as a result of an amalgamation after June 18, 1971 of two or more predecessor corporations is not a non-resident-owned investment corporation unless each of the predecessor corporations was, immediately before the amalgamation, a non-resident-owned investment corporation,

(*h*) where a corporation is a new corporation described in paragraph (*g*), and each of the predecessor corporations elected in a timely manner under paragraph (*e*), paragraph (*e*) shall be read, in its application to the new corporation, without reference to the words "the earlier of February 27, 2000 and", and

(*i*) subject to section 134.1, a corporation is not a non-resident-owned investment corporation in any taxation year that ends after the earlier of,

(i) the first time, if any, after February 27, 2000 at which the corporation effects an increase in capital, and

(ii) the corporation's last taxation year that begins before 2003;

(3) Subsection 133(8) of the Act is amended by adding the following in alphabetical order:

"increase in capital"
« augmentation de capital »

"increase in capital" in respect of a corporation means a transaction (other than a transaction carried out pursuant to an agreement in writing made before February 28, 2000, referred to in this definition as a "specified transaction") in the course of which the corporation

issues additional shares of its capital stock or incurs indebtedness, if the transaction has the effect of increasing the total of

(*a*) the corporation's liabilities, and

(*b*) the fair market value of all the shares of its capital stock

to an amount that is substantially greater than that total would have been on February 27, 2000 if all specified transactions had been carried out immediately before that day;

(4) Subsection (1) applies to taxation years that end after February 27, 2000 except that, for the taxation year of a corporation that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in paragraph 133(1)(*d*), as enacted by subsection (1), shall be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year, multiplied by".

(5) Subsections (2) and (3) apply after February 27, 2000.

80. (1) The Act is amended by adding the following after section 134:

NRO – transition

134.1 (1) This section applies to a corporation that

(*a*) was a non-resident-owned investment corporation in a taxation year;

(*b*) is not a non-resident-owned investment corporation in the following taxation year (in this section referred to as the corporation's "first non-NRO year"); and

(*c*) elects in writing filed with the Minister on or before the corporation's filing-due day for its first non-NRO year to have this section apply.

Application

(2) A corporation to which this section applies is deemed to be a non-resident-owned investment corporation in its first non-NRO year for the purposes of applying, in respect of dividends paid on shares of its capital stock in its first non-NRO year, subsections 133(6) to (9) (other than the definition "non-resident-owned investment corporation" in subsection 133(8)) and section 212 and any tax treaty.

(2) Subsection (1) applies to taxation years that end after 1996.

(3) An election under paragraph 134.1(1)(*c*) of the Act, as enacted by subsection (1), is deemed to have been made in a timely manner if it is made on or before the electing corporation's filing-due date for its first taxation year that ends after this Act receives royal assent.

81. (1) Subsection 147(10.5) of the Act is repealed.

(2) Subsection (1) applies to shares acquired, but not disposed of, before February 28, 2000 and to shares acquired after February 27, 2000.

82. (1) Subsection 150.1(5) of the Act is replaced by the following:

Application to other Parts

(5) This section also applies to Parts I.2 to XIII, with such modifications as the circumstances require.

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

83. (1) The description of A in paragraph (*b*) of the definition "net tax owing" in subsection 156.1(1) of the Act is replaced by the following:

A is the total of the taxes payable under this Part and Parts I.2 and X.5 by the individual for the year,

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

84. (1) Subparagraph 164(6.1)(*a*)(iii) of the Act is amended by replacing the reference to the fraction "1/4" with a reference to the fraction "1/2".

(2) Subsection (1) applies to deaths that occur after February 27, 2000 except that, for deaths that occurred after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" in subparagraph 164(6.1)(*a*)(iii) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction "1/3".

85. (1) Subsection 165(2.1) of the Act is replaced by the following:

Application

(2.1) Notwithstanding any other provision of this Act, paragraph (1)(*a*) shall apply only in respect of assessments, determinations and redeterminations under this Part and Part I.2.

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

86. (1) Section 169 of the Act is amended by adding the following after subsection (1):

Ecological gifts

(1.1) Where at any particular time a taxpayer has disposed of a property, the fair market value of which has been confirmed or redetermined by the Minister of the Environment under subsection 118.1(10.4), the taxpayer may, within 90 days after the day on which that Minister has issued a certificate under subsection 118.1(10.5), appeal the confirmation or redetermination to the Tax Court of Canada.

(2) Subsection (1) applies in respect of gifts made after February 27, 2000.

87. (1) Section 171 of the Act is amended by adding the following after subsection (1):

Ecological Gifts

(1.1) On an appeal under subsection 169(1.1), the Tax Court of Canada may confirm or vary the amount determined to be the fair market value of a property and the value determined by the Court is deemed to be the fair market value of the property determined by the Minister of the Environment.

(2) Subsection (1) applies in respect of gifts made after February 27, 2000.

88. (1) Subsection 180.1(1) of the Act is replaced by the following:

Individual surtax

180.1 (1) Every individual shall pay a tax under this Part for each taxation year equal to 5% of the amount, if any, by which the tax payable under Part I by the individual for the year exceeds $15,500.

(2) Part I.1 of the Act is repealed.

(3) Subsection (1) applies to the 2000 taxation year.

(4) Subsection (2) applies to the 2001 and subsequent taxation years.

89. (1) Subsection 206(3.1) of the Act is replaced by the following:

Acquisition of qualifying security

(3.1) For the purpose of applying subparagraph (2)(*a*)(iii) at or after a particular time, where a qualifying security in relation to another security is acquired at the particular time by the taxpayer referred to in subsection (3.2) in respect of the security, and the security is foreign property at that time,

(*a*) the qualifying security is deemed to have been last acquired by the taxpayer at the time the other security was last acquired by the taxpayer;

(*b*) where the other security was not foreign property immediately before the particular time, the qualifying security is deemed to have become foreign property at the particular time; and

(*c*) where the other security was foreign property immediately before the particular time, the qualifying security is deemed to have become foreign property at the time the other security became foreign property.

Qualifying security

(3.2) For the purpose of subsection (3.1), a qualifying security in relation to another security means

(*a*) a security issued at any time by a corporation to a taxpayer

(i) in exchange for another security acquired before that time by the taxpayer, and

(ii) in the course of

(A) a corporate merger or reorganization of capital,

(B) a transaction or series of transactions in which control of the corporation that issued the other security is acquired by a person or group of persons, or

(C) a transaction or series of transactions in which all or substantially all of the issued and outstanding shares (other than shares held immediately before the transaction or the beginning of the series by a particular person or related group) of the corporation that issued the other security are acquired by the particular person or related group; or

(*b*) a security acquired by a taxpayer from a corporation pursuant to a distribution with respect to another security that is an eligible distribution described in subsection 86.1(2).

(2) Subsection (1) applies to months that end after 1997.

90. (1) Paragraph 219(1)(*d*) of the Act is amended by striking out the expression "1/3 of".

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, for such taxation years that ended before October 18, 2000, the reference in paragraph 219(1)(*d*) of the Act, as enacted by subsection (1), to the expression "the amount" shall be read as a reference to the expression "1/2 of the amount".

91. Subsection 231.5(2) of the Act is replaced by the following:

Compliance

231.5 (2) No person shall <u>physically or otherwise</u> interfere with, hinder or molest any person <u>who does, or prevent any person from doing</u>, anything that the person is authorized by <u>this Act to do, or attempt to interfere with, hinder or molest</u> any person <u>who does</u>, or attempt to prevent any person <u>from</u> doing, any such thing and every person shall, unless the person is unable to do so, do everything the person is required to do by or pursuant to subsection (1) or sections 231.1 to 231.4.

92. (1) Subsection 241(3) of the Act is amended by striking out the word "or" at the end of paragraph (*a*), by adding the word "or" at the end of paragraph (*b*) and by adding the following after paragraph (*b*):

(*c*) the provision of taxpayer information to a police officer (within the meaning assigned by subsection 462.48(17) of the *Criminal Code*) solely for the purpose of investigating an alleged offence, or the laying of an information or the preferring of an indictment in respect of an alleged offence, where

(i) such information can reasonably be regarded as being relevant for the purpose of ascertaining the circumstances in which an

offence under the *Criminal Code* may have been committed, or the identity of the person or persons who may have committed an offence, in respect of an official, or in respect of any person related to that official,

(ii) the official performed or is performing an act which the Act obliges or authorizes the official to perform, and

(iii) the offence can reasonably be considered to be related to that act.

(2) Subsection 241(4) of the Act is amended by striking out the word "or" at the end of paragraph (*m*), by adding the word "or" at the end of paragraph (*n*) and by adding the following after paragraph (*n*):

(*o*) to provide taxpayer information to any person solely for the purpose of enabling the Chief Statistician, within the meaning assigned by section 2 of the *Statistics Act*, to provide to a statistical agency of a province data concerning business activities carried on in the province, where the information is used by the agency solely for research and analysis and the agency is authorized under the law of the province to collect the same or similar information on its own behalf in respect of such activities.

(3) Subsection (2) applies after this Act receives royal assent to information relating to the 1997 and subsequent taxation years and, for the purpose of subsection 17(2) of the *Statistics Act*, where such information was collected before this Act receives royal assent, the information is deemed to have been collected at the time at which it is provided to a provincial agency pursuant to paragraph 241(4)(*o*) of the *Income Tax Act*, as enacted by subsection (2).

93. (1) The definition "transfer pricing capital adjustment" in subsection 247(1) of the Act is replaced by the following:

"transfer pricing capital adjustment"
« redressement de capital »

"transfer pricing capital adjustment" of a taxpayer for a taxation year means the total of

(*a*) all amounts each of which is

(i) 1/2 of the amount, if any, by which the adjusted cost base to the taxpayer of a capital property (other than a depreciable property) is reduced in the year because of an adjustment made under subsection (2)

(ii) 3/4 of the amount, if any, by which the adjusted cost base to the taxpayer of an eligible capital expenditure of the taxpayer in respect of a business is reduced in the year because of an adjustment made under subsection (2), or

(iii) the amount, if any, by which the capital cost to the taxpayer of a depreciable property is reduced in the year because of an adjustment made under subsection (2); and

(*b*) all amounts each of which is that proportion of the total of

(i) 1/2 of the amount, if any, by which the adjusted cost base to a partnership of a capital property (other than a depreciable property) is reduced in a fiscal period that ends in the year because of an adjustment made under subsection (2),

(ii) 3/4 of the amount, if any, by which the adjusted cost base to a partnership of an eligible capital expenditure of the partnership in respect of a business is reduced in a fiscal period that ends in the year because of an adjustment made under subsection (2), and

(iii) the amount, if any, by which the capital cost to a partnership of a depreciable property is reduced in the period because of an adjustment made under subsection (2),

that

(iv) the taxpayer's share of the income or loss of the partnership for the period

is of

(v) the income or loss of the partnership for the period,

and where the income and loss of the partnership are nil for the period, the income of the partnership for the period is deemed to be $1,000,000 for the purpose of determining a taxpayer's share of the partnership's income for the purpose of this definition.

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the reference

to the fraction "1/2" in the definition "transfer pricing capital adjustment" in subsection 247(1) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 13(1), that applies to the taxpayer for the year.

94. (1) The definition "foreign resource property" in subsection 248(1) of the Act is replaced by the following

"foreign resource property"
« avoir minier étranger »

"foreign resource property" has the meaning assigned by subsection 66(15), <u>and a foreign resource property in respect of a country means a foreign resource property that is</u>

(*a*) a right, licence or privilege to explore for, drill for or take petroleum, natural gas or related hydrocarbons in that country,

(*b*) a right, licence or privilege to

(i) store underground petroleum, natural gas or related hydrocarbons in that country, or

(ii) prospect, explore, drill or mine for minerals in a mineral resource in that country,

(*c*) an oil or gas well in that country or real property in that country the principal value of which depends on its petroleum or natural gas content (but not including depreciable property),

(*d*) a rental or royalty computed by reference to the amount or value of production from an oil or gas well in that country or from a natural accumulation of petroleum or natural gas in that country,

(*e*) a rental or royalty computed by reference to the amount or value of production from a mineral resource in that country,

(*f*) a real property in that country the principal value of which depends upon its mineral resource content (but not including depreciable property), or

(*g*) a right to or interest in any property described in any of paragraphs (*a*) to (*f*), other than such a right or interest that the taxpayer has by reason of being a beneficiary of a trust;

(2) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"foreign resource expense"
« frais relatifs à des ressources à l'étranger »

"foreign resource expense" has the meaning assigned by subsection 66.21(1);

"foreign resource pool expenses"
« frais globaux relatifs à des ressources »

"foreign resource pool expenses" of a taxpayer means the taxpayer's foreign resource expenses in respect of all countries and the taxpayer's foreign exploration and development expenses;

"qualified donee"
« donataire reconnu »

"qualified donee" has the meaning assigned by subsection 149.1(1).

(3) Subsection (1) and the definitions "foreign resource expense" and "foreign resource pool expense in subsection 248(1) of the Act, as enacted by subsection (2), apply after 2000.

(4) The definition "qualified donee", as enacted by subsection (2), applies after 1998.

PART 2

AN ACT TO AMEND THE INCOME TAX ACT, THE CANADA PENSION PLAN, THE CULTURAL PROPERTY EXPORT AND IMPORT ACT, THE INCOME TAX CONVENTIONS INTERPRETATION ACT, THE TAX COURT OF CANADA ACT, THE UNEMPLOYMENT INSURANCE ACT, THE CANADA-NEWFOUNDLAND ATLANTIC ACCORD IMPLEMENTATION ACT, THE CANADA-NOVA SCOTIA OFFSHORE PETROLEUM RESOURCES ACCORD IMPLEMENTATION ACT AND CERTAIN RELATED ACTS

95. (1) Subsection 236(1) of *An Act to amend the Income Tax Act, the Canada Pension Plan, the Cultural Property Export and Import Act, the Income Tax Conventions Interpretation Act, the Tax Court of Canada Act, the Unemployment Insurance Act, the Canada-Newfoundland Atlantic Accord Implementation Act, the Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act and certain related Acts*, S.C. 1991, c. 49, is amended

(*a*) by replacing the reference to the words "3/4 of the amount determined under subparagraph (i) in respect of him" in paragraph 26(5)(*d*) of *An Act to amend the Income Tax Act and a related Act*, S.C. 1986, c. 55, with a reference to the words "the amount determined when the fraction required to be used by him in the year or fiscal period under paragraph 38(*a*) or (*b*) is multiplied by the amount determined under subparagraph (i) in respect of him"; and

(*b*) by replacing the reference to the words "3/4 of the amount determined under subparagraph (i) in respect of the proprietor" in paragraph 26(5)(*e*) of *An Act to amend the Income Tax Act and a related Act*, S.C. 1986, c. 55, with a reference to the words "the amount determined when the fraction required to be used by the proprietor in the year or fiscal period under paragraph 38(*a*) or (*b*) is multiplied by the amount determined under subparagraph (i) in respect of the proprietor".

(2) Subsection (1) is deemed to have come into force on December 19, 1986.

PART 3

CANADA PENSION PLAN

96. (1) The portion of subsection 12(1) of the *Canada Pension Plan* before paragraph (*a*) is replaced by the following:

Amount of contributory salary and wages

12. (1) The amount of the contributory salary and wages of a person for a year is his income for the year from pensionable employment, computed in accordance with the *Income Tax Act* (read without reference to subsection 7(8) of that Act), plus any deductions for the year made in computing that income otherwise than under paragraph 8(1)(*c*) of that Act, but does not include

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

PART 4

EXCISE TAX ACT

97. The *Excise Tax Act* is amended by adding the following after section 100:

Compliance

101. Every person who, physically or otherwise, does or attempts to do any of the following:

(*a*) hinder, molest or interfere with any other person doing anything the other person is authorized to do under this Act, or

(*b*) prevent any other person from doing anything the other person is authorized to do under this Act

is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

(*c*) a fine of not less than one thousand dollars and not more than twenty-five thousand dollars, or

(*d*) both a fine described in paragraph (*c*) and imprisonment for a term not exceeding twelve months.

98. Subsection 291(2) of the Act is replaced by the following:

Compliance

(2) No person shall, <u>physically or otherwise, do or attempt to do any of the following:</u>

(*a*) hinder, molest or interfere with any other person doing anything the other person is authorized to do under <u>this Part, or</u>

(*b*) prevent any other person from doing <u>anything the other person is authorized to do under this Part</u>

and every person shall, unless the person is unable to do so, do everything the person is required to do by or pursuant to subsection (1) or any of sections 288 to 290 and 292.

99. Subsection 295(4) of the Act is amended by striking out the word "or" at the end of paragraph (*a*), by adding the word "or" at the end of paragraph (*b*) and by adding the following after paragraph (*b*):

(*c*) the provision of confidential information to a police officer (within the meaning assigned by subsection 462.48(17) of the *Criminal Code*) solely for the purpose of investigating an alleged offence, or the laying of an information or the preferring of an indictment in respect of an alleged offence, if

(i) such information can reasonably be regarded as being relevant for the purpose of ascertaining the circumstances in which an offence under the *Criminal Code* may have been committed, or the identity of the person or persons who may have committed an offence, in respect of an official, or in respect of any person related to that official,

(ii) the official has performed or is performing an act that this Part obliges or authorizes the official to perform, and

(iii) the offence can reasonably be considered to be related to that act.

100. The portion of subsection 326(1) of the Act before paragraph (*a*) is replaced by the following:

Offences

326. (1) Every person who fails to file or make a return as and when required by or under this Part or who fails to comply with subsection 286(2) or 291(2) or with an order made under subsection (2) is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

Explanatory Notes

PREFACE

These explanatory notes describe proposed amendments to the *Income Tax Act*, the *Canada Pension Plan*, the *Excise Tax Act* and a related Act. These explanatory notes describe these amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin
Minister of Finance

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act*, the *Canada Pension Plan*, the *Excise Tax Act* and a related Act. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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Clause 1

Employee Stock Options

ITA
7

Section 7 of the *Income Tax Act* deals with agreements (commonly called stock options) under which employees of a corporation or mutual fund trust acquire rights to acquire securities of the employer (or a person with whom the employer does not deal at arm's length).

Agreement to Issue Securities to Employees

ITA
7(1)

Under subsection 7(1) of the Act, an employee who acquires a security under an employee option agreement is deemed to have received, in the year the security is acquired, a benefit from employment equal to the excess of the fair market value of the security over the amount paid by the employee to acquire the security. Subsection 7(1) is subject to subsection 7(1.1) of the Act. Subsection 7(1.1) provides that, where the security is acquired under an option granted to an arm's length employee by a Canadian-controlled private corporation (CCPC), subsection 7(1) is to be read so as to deem the employment benefit to have been received in the year the employee disposes of the security, rather than in the year the employee acquires the security.

Subsection 7(1) is amended so that it is also subject to new subsection 7(8). Subsection 7(8) provides that, where an employee acquires a security after February 27, 2000 under an option granted by a corporation (other than a CCPC) or by a mutual fund trust, subsection 7(1) is to be read so as to deem the employment benefit to have been received in the year the employee disposes of the security. In order for subsection 7(8) to apply, the acquisition must be a qualifying acquisition as described in new subsection 7(9), and the employee must elect to defer recognition of the benefit in accordance with new subsection 7(10). (See the commentary on those subsections for further details.)

It should be noted that amended subsection 7(1.3) of the Act provides rules for determining the order of the disposition of identical properties. In effect, securities for which a deferral is provided under subsection 7(1.1) or (8) are considered to be disposed of only after identical securities for which no deferral is provided and, then, in the order in which the employee acquired them. New subsection 47(3) of the Act provides that securities that are acquired after February 27, 2000, and for which a deferral is provided under subsection 7(1.1) or (8), are deemed, for the purpose of the cost-averaging rule in subsection 47(1), not to be identical to any other securities owned by the taxpayer. Consequently, each of the deferral securities will have its own unique adjusted cost base (ACB). Finally, it should be noted that, under amended paragraph 53(1)(*j*) of the Act, the ACB of a security that is acquired after February 27, 2000, and for which a deferral is provided under subsection 7(1.1) or (8), is determined as though the employment benefit were recognized, for tax purposes, at the time the security is acquired. (See the commentary on those provisions for further details.)

The amendment to subsection 7(1) applies to the 2000 and subsequent taxation years.

Order of Disposition of Securities

ITA
7(1.3)

Subsection 7(1.3) of the Act provides, for the purposes of subsection 7(1.1), a rule for determining the order in which a taxpayer disposes of shares that are identical properties. The rule is relevant in that subsection 7(1.1) defers recognition, for tax purposes, of the employment benefit arising from an employee's acquisition of a share under an option granted by a Canadian-controlled private corporation (CCPC) until the employee disposes of the share. The rule deems the employee to dispose of identical shares in the order in which the employee acquired them – that is, on a first-in-first-out basis.

Subsection 7(1.3) is amended in a number of ways. First, it is amended so that it also applies for the purpose of new subsection 7(8) of the Act and for the purposes of existing subdivision c, subparagraph 110(1)(*d*)(ii) and subsection 147(10.4) of the Act.

- Subsection 7(8) is similar to existing subsection 7(1.1) in that it defers recognition, for tax purposes, of the employment benefit arising from a taxpayer's acquisition of certain employee option securities until the securities are disposed of. Subsection 7(8) applies to publicly-listed shares, and mutual fund trust units, acquired after February 27, 2000. Extending the application of subsection 7(1.3) to subsection 7(8) ensures that it is possible to determine when a particular security for which a deferral has been provided under subsection 7(8) has been disposed of and, consequently, when the employment benefit that is associated with the taxpayer's acquisition of the security is to be recognized for tax purposes.

- Subdivision c sets out rules for determining taxable capital gains and allowable capital losses when a taxpayer disposes of capital property. Extending the application of subsection 7(1.3) to subdivision c ensures that, when a taxpayer disposes of a security that is identical to other securities owned by the taxpayer, the security that the taxpayer is considered to have disposed of for purposes of the employee security option rules in section 7 is also the security that the taxpayer is considered to have disposed of for purposes of the capital gains rules.

- Paragraph 110(1)(*d*.1) allows a taxpayer to deduct a portion of the employment benefit that the taxpayer is deemed, by subsection 7(1) of the Act, to have received when disposing of a share acquired under an employee option granted by a CCPC. Subparagraph 110(1)(*d*.1)(ii) requires that, in order to qualify for the deduction, the taxpayer must not dispose of the share within two years of acquiring it. Extending the application of subsection 7(1.3) to subparagraph 110(1)(*d*.1)(ii) ensures that, in those cases where the taxpayer holds identical shares, a determination can be made as to when a particular security that was acquired under a CCPC option is disposed of and, consequently, whether or not the taxpayer has satisfied the two-year hold requirement.

- Subsection 147(10.4) provides that, where a taxpayer disposes of shares which the taxpayer received as part of a lump sum payment on withdrawing from a deferred profit sharing plan (DPSP) and in respect of which the taxpayer filed an election under subsection 147(10.1) of the Act, the taxpayer is to include in income, in the year of disposition, an amount equal to the excess of the fair

market value of the shares when they were withdrawn over the cost amount of the shares to the DPSP. The application of subsection 7(1.3) to subsection 147(10.4) is consequential on the repeal of subsection 147(10.5) of the Act, which contains an ordering rule for subsection 147(10.4) that is identical to the rule in existing subsection 7(1.3).

Second, subsection 7(1.3) is amended to provide two rules for determining, for the purpose of that subsection, the order in which identical securities are considered to have been acquired.

- Paragraph 7(1.3)(*a*) provides that, where a taxpayer who holds securities that were acquired under circumstances to which any of subsections 7(1.1) or (8) or subsection 147(10.1) applied (referred to in these notes as "deferral securities") acquires identical securities that are not deferral securities, the new securities are deemed to have been acquired immediately before the earliest acquisition of the deferral securities. The effect of this deeming rule, in conjunction with the ordering rule for dispositions, is that a taxpayer holding both deferral and non-deferral securities is considered to dispose of the non-deferral securities first.

- Paragraph 7(1.3)(*b*) provides that, when a taxpayer acquires a number of identical deferral securities at one time, the securities are deemed to have been acquired in the order in which the options under which the securities are acquired were granted. The effect of this deeming rule, in conjunction with the ordering rule for dispositions, is that a taxpayer who acquires identical securities under different options at the same time is considered to dispose of those securities in the order in which the relevant options were granted.

Third, subsection 7(1.3) is amended so that it is subject to new subsection 7(1.31) and paragraph 7(14)(*c*) of the Act.

- New subsection 7(1.31) contains a special rule allowing a taxpayer who disposes of a security that is identical to other securities owned by the taxpayer to designate the most recently acquired security as the security being disposed of, provided certain conditions are met.

- New subsection 7(14) allows the Minister of National Revenue to treat an invalid deferral of an employment benefit arising from a taxpayer's acquisition of an employee option security as a valid deferral under new subsection 7(8) of the Act by sending a written notice to this effect to the taxpayer. If the taxpayer has not disposed of the security before the time the notice is sent, paragraph 7(14)(*c*) deems the taxpayer to have disposed of it at that time for the purposes of section 7. This ensures that the employment benefit is recognized and taxed at that time. Paragraph 7(14)(*c*) also deems the taxpayer to have reacquired the security immediately after that time, but not under an employee option agreement. Thus, from that point on, the security is treated, for the purposes of the ordering rule in subsection 7(1.3), as a non-deferral security.

It should be noted that new subsection 47(3) of the Act provides that securities that are acquired after February 27, 2000, and for which a deferral is provided under subsection 7(1.1) or (8) or 147(10.1), are deemed, for the purpose of the cost-averaging rule in subsection 47(1), not to be identical to any other securities owned by the taxpayer. Consequently, the adjusted cost base (ACB) of each such security, and thus the capital gain or loss on the disposition of the security, is determined without regard to the ACB of any other securities owned by the taxpayer. (See the commentary on new subsection 47(3), and the examples provided as part of that commentary, for further details.)

Amended subsection 7(1.3) applies to securities acquired after February 27, 2000. It also applies to securities acquired, but not disposed of, before February 28, 2000.

Disposition of Newly-Acquired Securities

ITA
7(1.31)

New subsection 7(1.31) of the Act contains a special provision which applies when a taxpayer disposes of a security that is identical to other securities owned by the taxpayer. The provision deems a particular security, as designated by the taxpayer, to be the security that is the subject of the disposition. In order for this subsection to apply, certain conditions must be met.

First, the particular security must have been acquired under an employee option agreement, as described in subsection 7(1) of the Act.

Second, the disposition must occur no later than 30 days after the taxpayer acquires the particular security.

Third, there must be no other acquisitions or dispositions of identical securities in the intervening period; that is, after the acquisition of the particular security and before the disposition in respect of which the designation is being made. It should be noted, however, that this does not preclude the taxpayer from acquiring other identical securities at the same time as the particular security is acquired, or from disposing of other identical securities at the same time as the disposition in respect of which the designation is being made.

Fourth, the taxpayer must make the designation in the return of income that is filed for the year in which the disposition occurs. It is expected that the Minister of National Revenue will accept, as the form of designation, the calculation of the capital gain or loss in respect of the disposition on the basis that it is the particular security that is the subject of the disposition.

Finally, the taxpayer must not have designated the particular security in connection with the disposition of any other security.

Example

On May 1, 2000, Joseph acquires 750 shares of his corporate employer on the open market. On May 1, 2001, he acquires another 750 shares on the open market. On May 1, 2002, he acquires an additional 1,000 shares under employee stock options. Immediately thereafter, he sells 1,500 shares. In his return of income for 2002, he designates the 1,000 stock option shares as constituting part of the shares that were sold. Pursuant to subsections 7(1.3) and (1.31), the 1,500 shares being sold by Joseph are deemed to be comprised of the 1,000 stock option shares and 500 of the 750 shares that Joseph acquired on the open market on May 1, 2000.

It should be noted that the provisions of subsection 7(1.31) accommodate the practice of specific identification that is currently

permitted by the Canada Customs and Revenue Agency (CCRA). (See CCRA's Income Tax Technical News No. 19, dated June 16, 2000, for further details.) The significance of subsection 7(1.31) for the purpose of new paragraph 110(1)(*d*.01) should also be noted. That paragraph allows a taxpayer to deduct a portion of the employment benefit that the taxpayer is deemed by subsection 7(1) to have received in respect of the taxpayer's acquisition of a qualifying employee option security, if the taxpayer disposes of the security by donating it to a qualifying charity within 30 days after its acquisition.

It should also be noted that new subsection 47(3) of the Act provides that securities to which subsection 7(1.31) apply are deemed, for the purpose of the cost-averaging rule in subsection 47(1), not to be identical to any other securities owned by the taxpayer. Consequently, the adjusted cost base (ACB) of each such security, and thus the capital gain or loss on the disposition of the security, is determined without regard to the ACB of any other securities owned by the taxpayer. (See the commentary on new subsection 47(3), and the examples provided as part of that commentary, for further details.)

New subsection 7(1.31) applies to securities acquired after February 27, 2000. It also applies to securities acquired, but not disposed of, before February 28, 2000.

Exchange of Options

ITA
7(1.4)

Under subsection 7(1) of the Act, an employee who disposes of an employee security option will generally be treated, for income tax purposes, as having received a benefit from employment at the time of the disposition. Subsection 7(1.4) of the Act provides an exception to this treatment in connection with qualifying dispositions under which an employee's option is exchanged for a new option. Subsection 7(1.4) accomplishes this by deeming the exchange not to have occurred for the purposes of section 7.

Subsection 7(1.4) is amended so that this deeming rule does not apply for the purpose of new subparagraph 7(9)(*d*)(ii). New subsection 7(9) sets out some of the conditions that must be met to be eligible, under

new subsection 7(8), to defer taxation of the employment benefit associated with the acquisition of a security under an employee option agreement. The specific condition set out in subparagraph 7(9)(*d*)(ii) applies if the employee had received the option in exchange for other options. The amendment to subsection 7(1.4) is consequential on the introduction of subparagraph 7(9)(*d*)(ii) and ensures that the condition in that subparagraph can be applied.

This amendment applies to the 2000 and subsequent taxation years.

Rules Where Securities Exchanged

ITA
7(1.5)

Subsection 7(1.5) of the Act contains a special rule that applies for the purposes of the rules in subsection 7(1.1) and paragraph 110(1)(*d*.1). Subsection 7(1.1) provides that, if an arm's length employee acquires a share under an option granted by a Canadian-controlled private corporation (CCPC), recognition of the employment benefit for tax purposes is deferred until the employee disposes of the share. When the employee disposes of the share and is taxed on the employment benefit, paragraph 110(1)(*d*.1) allows the employee to deduct a portion of the benefit if the share has been held for at least two years.

Under subsection 7(1.5), a qualifying exchange of shares acquired under an option granted by a CCPC for other shares is deemed not to be a disposition for the purposes of subsection 7(1.1) and paragraph 110(1)(*d*.1), and the new shares are deemed to be a continuation of the old shares. Consequently, taxation of the employment benefit associated with the old shares is deferred until the employee disposes of the new shares, and the two-year hold requirement for the deduction is based on the combined amount of time that the old and new shares are held. To qualify, the exchange must be for shares of a corporation within the corporate group (including corporations formed on an amalgamation or merger), the employee must receive no consideration for the disposition of the old shares other than the new shares, and the value of the new shares must be no greater than the value of the old shares.

Subsection 7(1.5) is amended so that it also applies to exchanges of employee option securities acquired under circumstances to which new subsection 7(8) applies. Subsection 7(8), which applies to publicly-listed shares and mutual fund trust units acquired under employee option agreements after February 27, 2000, defers recognition of the employment benefit associated with the acquisition of the security until the security is disposed of, provided certain conditions are met. (See the commentary on subsection 7(8) for further details.) The extension of subsection 7(1.5) to these securities ensures that the deferral provided by subsection 7(8) does not cease if the security is exchanged for another qualifying security.

Subsection 7(1.5) is also amended so that it applies for purposes of new paragraph 110(1)(*d*.01) of the Act, which allows a special deduction in computing income when an employee donates an employee option security acquired after February 27, 2000 to a qualifying charity. The extension of subsection 7(1.5) to these circumstances ensures that the special deduction is not lost if the employee exchanges the option security for another qualifying security, in accordance with subsection 7(1.5), and donates the new security to charity.

Finally, subsection 7(1.5) is amended so that the rule in paragraph 7(1.5)(*e*) which deems the new securities to be the same securities as, and a continuation of, the old securities does not apply so as to deem the new securities to be identical to securities to which they would not otherwise be identical. This ensures that the rules in subsections 7(1.3) and (1.31) of the Act, which deem identical securities to be disposed of in a particular order, do not apply to identify a particular security as the security that is disposed unless the security is, in fact, identical to the security that is the subject of the disposition.

It should be noted that where a taxpayer acquires an employee option security after February 27, 2000, and the security is acquired under circumstances to which subsection 7(1.1) or (8) applied, the employment benefit that will be recognized only at the time of the disposition of the security is, nevertheless, added to the adjusted cost base of the security at the time the security is acquired pursuant to amended paragraph 53(1)(*j*) of the Act. Thus, if the security is exchanged for another security under circumstances to which subsection 7(1.5) applies but for which there is no rollover for capital

gains purposes, the benefit is taken into account in determining the capital gain or loss on the disposition of the old security.

The amendments to subsection 7(1.5) apply to exchanges of securities that occur after February 27, 2000.

Securities Held by Trustee

ITA
7(2)

Subsection 7(2) of the Act provides that, where a trust holds securities for an employee, acquisitions and dispositions of the securities by the trust are treated as acquisitions and dispositions by the employee for the purposes of section 7 and paragraphs 110(1)(*d*) and (*d*.1) of the Act.

Subsection 7(2) is amended so that it also applies for the purpose of new paragraph 110(1)(*d*.01). Paragraph 110(1)(*d*.01) allows an employee to deduct a portion of the amount of the benefit that the employee is deemed by subsection 7(1) to have received in respect of the acquisition of certain employee option securities where the securities (or, under certain circumstances, proceeds from the disposition of such securities) are donated to a qualifying charity.

This amendment applies to the 2000 and subsequent taxation years.

Sale to Trustee for Employees

ITA
7(6)(*a*)

Subsection 7(6) of the Act provides a rule which applies where an employer (or a non-arm's length person) has entered into an arrangement under which its securities (or securities of a non-arm's length person) are sold or issued to a trustee for sale to an employee. It provides that, for the purposes of section 7 and paragraphs 110(1)(*d*) and (*d*.1), the employee's rights under the arrangement are treated as having arisen under an employee security option agreement.

Paragraph 7(6)(*a*) is amended so that this rule also applies for the purpose of new paragraph 110(1)(*d*.01). Paragraph 110(1)(*d*.01)

allows an employee to deduct a portion of the amount of the benefit that the employee is deemed by subsection 7(1) to have received in respect of the acquisition of certain employee option securities where the securities (or, under certain circumstances, proceeds from the disposition of such securities) are donated to a qualifying charity.

This amendment applies to the 2000 and subsequent taxation years.

Definitions

ITA
7(7)

Subsection 7(7) of the Act defines the expressions "qualifying person" and "security" for the purposes of section 7 and paragraph 110(1)(*d*). "Qualifying person" is defined as a corporation or a mutual fund trust. "Security" is defined as a share issued by a corporation or a unit of a mutual fund trust.

Subsection 7(7) is amended so that the definitions also apply for the purposes of new subsection 47(3), amended paragraph 53(1)(*j*), new paragraph 110(1)(*d*.01), amended subsection 110(1.5) and new subsections 110(1.6) and (2.1) of the Act.

- New subsection 47(3) exempts from the cost-averaging rule in subsection 47(1) of the Act certain securities acquired either under an employee option agreement or on withdrawal from a deferred profit sharing plan.

- Amended paragraph 53(1)(*j*) adds, to the adjusted cost base of an employee option security, the employment benefit that subsection 7(1) deems the employee to have received in connection with the acquisition of the security.

- New paragraph 110(1)(*d*.01) and subsection 110(2.1) allow an employee to deduct a portion of the employment benefit that the employee is deemed, by subsection 7(1), to have received in connection with the acquisition of a qualifying employee option security if, within 30 days of the acquisition, the employee donates the security (or proceeds from the disposition of the security) to a qualifying charity.

- Amended subsection 110(1.5) and new subsection 110(1.6) contain interpretative rules that apply for purposes of determining if the conditions for the deduction in paragraph 110(1)(*d*) are satisfied. Paragraph 110(1)(*d*) allows an employee to deduct a portion of the employment benefit that the employee is deemed, by subsection 7(1), to have received in connection with the exercise or disposition of rights under a security option agreement.

The extension of subsection 7(7) to these provisions is consequential on either the introduction of the relevant provision, or an amendment to the relevant provision. For subsections 110(1.5) and (1.6), the extension of subsection 7(7) applies after 1997. In all other cases, it applies after 1999.

Deferral for Employee Options on Publicly-Listed Shares and Mutual Fund Trust Units

ITA
7(8) to (16)

New subsections 7(8) to (16) of the Act contain special rules allowing for the deferral of taxation on the employment benefit realized when an employee acquires securities (i.e., shares of the capital stock of a corporation or units of a mutual fund trust) under an option granted by the employer or a person not dealing at arm's length with the employer, provided certain conditions are met. The deferral will cease when the employee disposes of the security, dies or ceases to be resident in Canada.

The following are the main features of the deferral measure.

- The deferral is available only in respect of securities acquired after February 27, 2000 by Canadian residents.

- If the employee option security is a share, the deferral is available only if the share is of a class of shares listed on a Canadian or foreign prescribed stock exchange.

- The deferral does not apply to options granted by Canadian-controlled private corporations (CCPCs), since a deferral is already available on such options under subsection 7(1.1) of the Act.

- The deferral is available only if the employee is entitled to a deduction under paragraph 110(1)(*d*). Generally speaking, an employee is entitled to a deduction under that paragraph when the following conditions are satisfied:

  - the amount paid by the employee to acquire the security was not less than the fair market value of the security when the option was granted;

  - the employee was dealing at arm's length, immediately after the option was granted, with the employer, the entity that granted the option and the entity whose securities could be acquired under the option; and

  - if the security is a share, it is an ordinary common share.

- If the employee option security is a share, the deferral is not available if the employee was, immediately after the option was granted, a specified shareholder of the employer, the corporation that granted the option or the corporation whose shares could be acquired under the option.

- The deferral is subject to an annual limit of $100,000. The limit is based on the year in which the options vest (i.e., first become exercisable), and on the fair market value of the underlying securities when the options were granted. Thus, for options vesting in a given year, an employee will be able to defer taxation on the acquisition of securities having a total fair market value (determined at the time the options were granted) not exceeding $100,000.

- The deferral is not automatic: it requires that the employee file an election with an entity that is involved in the option agreement (i.e., the employer, the entity that granted the option or the entity whose securities were acquired under the option). The elective nature of the deferral allows an employee who has options in excess of the $100,000 limit vesting in a particular year to choose those options for which the deferral will be claimed.

- The deferred amount is to be reported as a special item on the employee's T4 slip in the year in which the security is acquired. The employee is required to include the deferred amount in

computing income from employment when completing the tax return for the year in which the deferral ceases.

There are a number of other provisions in the Act that relate to securities for which a deferral is provided under new subsection 7(8). First, deferral securities are subject to the rules in amended subsection 7(1.3) of the Act, which determine the order in which identical securities are disposed of by a taxpayer. Second, deferral securities are subject to the security-for-security exchange rules in amended subsection 7(1.5) of the Act, which provide for a continued deferral of the employment benefit associated with the old security, if certain conditions are met. Third, deferral securities are subject to new subsection 47(3), which has the effect of excluding such securities from the cost-averaging rule in subsection 47(1). Finally, pursuant to amended paragraph 53(1)(*j*), the employment benefit associated with a deferral security is added to the adjusted cost base of the security when the security is acquired, even though the benefit is not taxed until the employee disposes of the security. (See the commentary on those provisions, and in particular the examples provided as part of the commentary on subsection 47(3), for further details.)

Deferral in Respect of Non-CCPC Employee Options

ITA
7(8)

When an employee acquires a security under an option granted by an employer or a person not dealing at arm's length with the employer, paragraph 7(1)(*a*) of the Act deems the employee to have received a taxable employment benefit equal to the fair market value of the security at the time it is acquired less the amount paid by the employee to acquire the security. In most cases, the benefit is recognized in the year in which the security is acquired. However, in the case of shares acquired under options granted to arm's length employees by Canadian-controlled private corporations (CCPCs), recognition of the benefit is deferred, by virtue of subsection 7(1.1), from the year in which the employee acquires the share to the year in which the employee disposes of the share.

New subsection 7(8) of the Act extends, with some modifications and limitations, the deferral currently available for CCPC options to options granted by corporations that are not CCPCs and to options

granted by mutual fund trusts. In order to be eligible for the deferral, the acquisition must be a qualifying acquisition as defined in new subsection 7(9), and the employee must file an election to defer in accordance with new subsection 7(10). (See the commentary on those subsections for further details.)

Example

In 2001, Jean exercises an option to acquire a share of the capital stock of his employer. The exercise price is $10, which was the fair market value of the share when the option was granted. At the time of acquisition, the share is worth $100. The acquisition is a qualifying acquisition, as described in subsection 7(9), and Jean files an election under subsection 7(10) to defer recognition of the employment benefit in respect of the acquisition. Jean sells the share in 2003, when the share is worth $300. He owns no other shares of the employer.

On Jean's T4 slip for 2001, the employer reports the deferred employment benefit of $90 (= $100 - $10). In filing his tax return for 2003, Jean reports the $90 benefit as employment income as well as the capital gain of $200 (= $300 – ($10 + $90)) realized on the sale of the share.

When recognition of an employment benefit is deferred under subsection 7(8), it is deferred until the employee disposes of the security. It should be noted that, if the employee does not sell the security before death, there will be a deemed disposition under section 70 of the Act at the time of death. Likewise, if the employee ceases to be resident in Canada before selling the security, there will be a deemed disposition under section 128.1 of the Act at the time of emigration. The exemption of certain employee option securities from the deemed disposition rules on emigration (as provided for under subsection 7(1.6) of the Act as proposed in Bill C-43, tabled in the House of Commons on September 20, 2000) will not apply to securities for which a deferral is provided under subsection 7(8). Consequently, employment benefits that are deferred under subsection 7(8) will be taxed no later than the year in which the employee dies or ceases to be resident in Canada.

Meaning of "Qualifying Acquisition"

ITA
7(9)

New subsection 7(9) of the Act sets out the requirements that must be met for the acquisition of a security under an employee option agreement to be considered to be a qualifying acquisition for the purposes of subsection 7(8). If the acquisition is a qualifying acquisition, subsection 7(8) provides for the recognition (and, thus, the taxation) of the associated employment benefit to be deferred, at the election of the employee, from the year the employee acquires the security to the year the employee disposes of the security.

In order for an employee's acquisition of a security under an option agreement to be a qualifying acquisition, the following conditions must be satisfied.

Timing of Acquisition

Paragraph 7(9)(*a*) requires that the acquisition occur after February 27, 2000. There are no constraints as to when the option was granted, or when it vested (i.e., first became exercisable). Thus, for example, an acquisition of a security in 2001 will not fail to be a qualifying acquisition because the option under which the acquisition occurs was granted in 1998 and vested in 1999.

Entitlement to Deduction under Paragraph 110(1)(d)

Paragraph 7(9)(*b*) requires that the employee be entitled to a deduction under paragraph 110(1)(*d*) in respect of the security. This means that the following conditions must also be satisfied.

- The amount paid by the employee to acquire the security (including any amount paid to acquire the right to acquire the security) must be not less than the fair market value of the security when the option was granted, unless the employee acquired the option as a result of one or more exchanges of options to which subsection 7(1.4) applied. Where there have been such exchanges, there are a number of conditions relating to the exercise price that must be satisfied. (See the commentary on amended paragraph 110(1)(*d*) for further details.)

- At the time immediately after the option was granted, the employee must have been dealing at arm's length with the employer, the entity granting the option and the entity whose securities could be acquired under the option. If there were any exchanges of options to which subsection 7(1.4) applied, this requirement applies to the original option.

- If the security is a share, it must be a prescribed share as described in section 6204 of the *Income Tax Regulations*. In general terms, a prescribed share is an ordinary common share.

Non-Specified Shareholder

Paragraph 7(9)(*c*) requires that, at the time immediately after the option was granted, the employee not be a specified shareholder of the employer, the entity granting the option or the entity whose securities could be acquired under the option. (In general terms, a person is a "specified shareholder" of a corporation, as defined in subsection 248(1) of the Act, if the person owns, directly or indirectly, at least 10% of the issued shares of any class of the capital stock of the corporation or a related corporation.) If there were any exchanges of options to which subsection 7(1.4) applied, this condition applies to the original option since each new option is deemed to be the same as, and a continuation of, the original option.

Publicly-Listed Share

Paragraph 7(9)(*d*) requires that, if the security is a share, it be of a class of shares listed on a Canadian or foreign stock exchange described in section 3200 or 3201 of the Regulations. Furthermore, if there were any exchanges of options to which subsection 7(1.4) applied, none of the shares that could have been acquired under any of the options being disposed of were, at the time of the exchange, of a class of shares that was not listed on such a stock exchange. Thus, an employee's acquisition of a publicly-listed share under an option acquired as a result of one or more exchanges of options to which subsection 7(1.4) applied will not qualify for deferral if any of the previously-exchanged options allowed the employee to acquire shares that, at the time of the exchange, were unlisted.

This requirement ensures that the $100,000 annual vesting limit in new paragraph 7(10)(*c*) cannot be circumvented by establishing a

class of shares exclusively for employee options which would have little or no fair market value at the time the options are granted but which would have the potential for growth, in absolute dollars, that is similar to other shares of the corporation.

Election for Purposes of Subsection (8)

ITA
7(10)

New subsection 7(8) of the Act provides for the recognition (and, thus, the taxation) of the employment benefit in connection with a qualifying acquisition of an employee option security to be deferred until disposition of the security, if the employee makes an election to defer in accordance with new subsection 7(10) of the Act. It should be noted that subsection 7(13) of the Act allows an employee to revoke an election made in accordance with subsection 7(10). The effect of such a revocation is that the election is deemed never to have been made. (See the commentary on subsection 7(13) for further details.)

In order for an election to defer recognition of the employment benefit associated with the acquisition of an employee option security to be in accordance with subsection 7(10), the following conditions must be satisfied.

Timing, Form and Manner of Election

Paragraph 7(10)(*a*) requires that the employee file the election on or before January 15th of the year following the year in which the security is acquired. However, if the security is acquired in 2000, the filing deadline is extended to February 15, 2001.

Paragraph 7(10)(*a*) requires that the election be filed with a person who will be required to report the deferred employment benefit to the Minister of National Revenue. Under proposed subsection 200(5) of the Regulations, each of the following will be jointly liable for so reporting the deferred employment benefit: the employer, the entity that granted the option and the entity whose security is acquired under the option. (See Appendix A for further details.)

Finally, paragraph 7(10)(*a*) requires that the employee file the election in such prescribed form and manner as is determined by the Minister of National Revenue.

Residency Status of Employee

Paragraph 7(10)(*b*) requires that, when the employee acquires the security in respect of which the election is made, the employee be resident in Canada.

$100,000 Annual Vesting Limit

Paragraph 7(10)(*c*) requires that the election be in respect of a particular security which has a specified value that, when added to the total specified value of certain other employee option securities, does not exceed $100,000. The other securities that are relevant for this purpose are those in respect of which the employee has filed (at or before the time that the election in respect of the particular security is filed) an election in accordance with subsection 7(10) and that were acquired under options that vested (i.e., first became exercisable) in the same year as the option under which the particular security is acquired.

It should be noted that where options are exchanged for other options under subsection 7(1.4), the new options are deemed to be the same as, and a continuation of, the original options. Therefore, to the extent that all or a portion of the rights under the old options had vested before the exchange, a corresponding portion of the new rights would be considered to have vested at the same time as the old options.

The specified value of a security acquired under an employee option agreement is determined in accordance with new subsection 7(11) of the Act. In many instances, the specified value will be the fair market value of the security at the time the option was granted. However, if there have been exchanges under subsection 7(1.4) or the security has been subject to splits or consolidations, the specified value will be the initial fair market value adjusted to take into account such events. (See the commentary on new subsection 7(11) for further details.)

The following examples illustrate the application of the $100,000 annual vesting limit. In each example, it is assumed that all other conditions for the deferral are met.

Example 1

In January 2001, Suzanne's corporate employer grants her options to acquire 16,000 company shares. The exercise price is $10 a share, which is the fair market value of the shares at the time the options are granted. Half of the options vest in 2001, the other half in 2002. Suzanne exercises all of the options in 2004, at which time the shares have a fair market value of $100 each. Suzanne wishes to take maximum advantage of the deferral available under subsection 7(8).

The 8,000 shares that Suzanne acquired under the options that vested in 2001 have a total specified value of $80,000 (= 8,000 x $10). The 8,000 shares that Suzanne acquired under the options that vested in 2002 also have a total value of $80,000. Since the total specified value for each vesting year does not exceed $100,000, Suzanne elects to defer on all of the options.

On Suzanne's T4 slip for 2004, the employer reports the deferred employment benefit of $1,440,000 (= 16,000 x ($100 - $10)) as a special memo item. This amount will be taxable only when Suzanne disposes of the shares.

Example 2

The facts are the same as in example 1, except that all of the options vest in 2001.

Since the shares that Suzanne acquired under options that vested in 2001 have a total specified value of $160,000, which is in excess of the $100,000 vesting limit for 2001, Suzanne cannot elect to defer on all of the options. She elects to defer on 10,000 options, which have a total specified value of $100,000.

On Suzanne's T4 slip for 2004, the employer reports the deferred employment benefit of $900,000 (= 10,000 x ($100 - $10)) as a special memo item which is taxable only in the year of disposition,

and the remaining employment benefit of $540,000 (= 6,000 x ($100 - $10)) as employment income which is taxable in 2004.

Example 3

On January 1, 2001, Mario's corporate employer grants him options to acquire 10,000 company shares. The exercise price is $10 a share, which is the fair market value of the shares at the time the options are granted. The options vest on January 1, 2003. On July 1, 2002, his employer grants him options on another 10,000 shares. The exercise price is $5 a share, which is the fair market value of the shares at that time. These options vest on July 1, 2003. Mario exercises all of the $10 options on January 1, 2003, when the shares have a fair market value of $100. He exercises all of the $5 options on July 1, 2003, when the shares have a fair market value of $150.

The specified value of the options that vested in January 2003 is $100,000 (= 10,000 x $10). The specified value of the options that vested in July 2003 is $50,000 (= 10,000 x $5). Since the total specified value of options vesting in 2003 exceeds $100,000, Mario cannot defer on all of the options. He wishes to defer on those options which will maximize the amount of employment benefit that is deferred.

The employment benefit on the options exercised in January is $90 (= $100 - $10) per share and $145 (= $150 - $5) per share on the options exercised in July. Accordingly, Mario elects to defer on all of the options exercised in July (which have a specified value of $50,000 and a deferred employment benefit of $1,450,000 (= 10,000 x $145)). He also elects to defer on half of the options exercised in January (which also have a specified value of $50,000 but a deferred employment benefit of $450,000 (= 5,000 x $90)). The employment benefit of $450,000 on the remaining options exercised in January is taxable in 2003.

On Mario's T4 slip for 2003, the employer reports the total deferred employment benefit of $1,900,000 (= $1,450,000 + $450,000) as a special memo item which is taxable only in the year of disposition, and the remaining employment benefit of $450,000 as employment income which is taxable in 2003.

Meaning of "Specified Value"

ITA
7(11)

New subsection 7(11) of the Act defines the term "specified value" of a security acquired under an employee option agreement for purposes of the $100,000 annual vesting limit in new paragraph 7(10)(*c*). The $100,000 limit is relevant in determining whether or not the employee can elect to defer taxation on the employment benefit arising from the acquisition of the security.

In many instances, the specified value is the fair market value of the security at the time the option was granted. However, if there have been exchanges under subsection 7(1.4) or the security has been subject to splits or consolidations, the specified value is the initial fair market value adjusted to take into account such events.

More specifically, the specified value of a security acquired under an employee security option is defined as the amount determined by the formula A/B.

Amount A in the formula is the fair market value of a security that could be acquired under the option at the time the option was granted. Where there have been one or more exchanges under subsection 7(1.4), the original option is the option that is relevant in determining amount A since that subsection deems each new option to be the same as, and a continuation of, the original option.

Where there have been no exchanges of options and no other modifications to the number or type of securities that can be acquired under the option, amount B in the formula is "1". In any other case, amount B is the number of securities that it is reasonable to consider that the employee could acquire, after taking all such exchanges and modifications into account, in lieu of one security under the original option at the time it was granted. The most common modifications that would be relevant for this purpose (other than exchanges under subsection 7(1.4)) are structural changes, such as splits and consolidations, in the securities that are the subject of the option.

The following examples illustrate the determination of the specified value of a security acquired under an employee security option where there have been modifications to the original option.

Example 1

Richard is granted an option to acquire a share for $20, which is the fair market value of the share at the time the option is granted. There is a 4-for-1 share split, with an automatic adjustment to Richard's option allowing him to acquire 4 shares at an exercise price of $5 each. Immediately after the split, Richard exercises his option and acquires all 4 shares.

Amount A in the "specified value" formula is $20, which is the fair market value, at the time the option was granted, of the particular security that could be acquired under the option at that time. Amount B in the formula is 4, since Richard was able to acquire 4 shares in lieu of the 1 share that could be acquired under the option at the time the option was granted. Therefore, the specified value of each share acquired under the option is $5 (= $20/4).

Example 2

Anne's employer, Company X, grants her options to acquire 10 shares. The exercise price is $10 a share, which is the fair market value of a Company X share at the time of grant. Company X is acquired by Company Y at a time when Company X shares are worth $100 each and Company Y shares are worth $200 each. Anne's options are exchanged for options to acquire 5 Company Y shares at an exercise price of $20 a share. Anne exercises the options immediately after the exchange.

Amount A in the "specified value" formula is $10, which is the fair market value, at the time the original option was granted, of a Company X share. Amount B in the formula is 0.5, since Anne was able to acquire only 1/2 of a Company Y share in lieu of 1 Company X share. Therefore, the specified value of each Company Y share is $20 (= $10/0.5).

Example 3

The facts are the same as in Example 2 except that, before Anne exercises the options, there is 4-for-1 split of Company Y shares. There is an automatic adjustment to Anne's options, allowing her to acquire 20 Company Y shares for $5 each. Anne exercises the options immediately after the split.

Amount A is $10, which is the fair market value, at the time the original option was granted, of a Company X share. Amount B is 2, since Anne was able to acquire 2 Company Y shares in lieu of 1 Company X share. Therefore, the specified value of each Company Y share is $5 (= $10/2).

Identical Options – Order of Exercise

ITA
7(12)

New subsection 7(12) of the Act provides a special rule for determining the order in which identical options are considered to be exercised. This is relevant primarily for purposes of applying the $100,000 annual vesting limit in paragraph 7(10)(*c*) to a particular security acquired under an employee option agreement.

In applying the $100,000 limit, it is necessary to determine the vesting year for the option being exercised (i.e., the year in which the option to acquire the security first became exercisable). It is also necessary to determine the vesting year of any other employee option securities for which the employee has elected a deferral under subsection 7(8). If there are identical options that have vested in different years, absent new subsection 7(12) it may not be possible to determine, when an option is exercised, which particular option is being exercised and, thus, what the vesting year is for the particular option.

Where this is the case, subsection 7(12) allows the employee to designate those options which are considered to have been exercised. If the employee does not so designate, identical options are considered to have been exercised in the order in which they first became exercisable, and identical options that first became exercisable at the same time, but were granted at different times, are

considered to have been exercised in the order in which they were granted.

Example

On July 1, 2001, Kevin's corporate employer grants him options on 20,000 company shares. The exercise price is $10 a share, which is the fair market value of the shares at that time. Half of the options vest immediately; the other half vest on July 1, 2002.

On July 1, 2002, Kevin's employer grants him options on another 20,000 company shares. The exercise price is $10 a share, which is the fair market value of the shares at that time. Again, half the options vest immediately; the other half on July 1, 2003.

On July 1, 2005, Kevin acquires 30,000 shares under his options.

Unless Kevin designates which particular options are considered to have been exercised, he is considered to have exercised the 10,000 options that vested on July 1, 2001 and the 20,000 options that vested on July 1, 2002 (10,000 of which were granted in 2001 and 10,000 of which were granted in 2002). Since the total specified value on the options that vested in 2001 is $100,000, Kevin can elect to defer, under subsection 7(8), the full employment benefit on those options. However, since the total specified value on the options that vested in 2002 is $200,000, he can elect to defer on only half of those options.

To maximize the deferral available to him, Kevin designates the options exercised as being the 10,000 options that vested on July 1, 2001 and July 1, 2003, and 10,000 of the 20,000 options that vested on July 1, 2002. This keeps him within the $100,000 limit for each vesting year and, thus, allows him to defer the employment benefit on all of the 30,000 options exercised. No deferral will be available, however, when he subsequently exercises the remaining 10,000 options that vested on July 1, 2002.

It should be noted that the designation permitted under subsection 7(12) may be used in respect of options exercised before February 28, 2000, where the designation will allow for a deferral which might not otherwise be allowed on options exercised after February 27, 2000.

Example

In 1996, Hélène is granted options that have a total specified value of $400,000. Half of the options vest in 1997; the other half in 1998. In 1999, Hélène exercises half of the options and, in July 2000, she exercises the remaining options. To maximize the deferral under subsection 7(8), Hélène chooses to designate half of the options vested in each of 1997 and 1998 as the options which she exercised in 1999. This allows her to designate the remaining options as the options which she exercised in July 2000 and, since the total specified value for options exercised and deferred from each of the vesting years does not exceed $100,000, she is able to elect to defer the employment benefit on all of the options exercised in 2000.

Revoked Election

ITA
7(13)

New subsection 7(13) of the Act allows for the revocation of an election made in accordance with subsection 7(10) to defer recognition of a security option benefit under subsection 7(8).

Where an election is revoked in accordance with subsection 7(13), the election is deemed never to have been made. As a result, the employment benefit associated with the acquisition of the security is taxed in the year of acquisition, rather than in the year of disposition. Furthermore, the "specified value" of the security (as defined in subsection 7(11)) ceases to be relevant for the purpose of applying the $100,000 annual vesting limit in paragraph 7(10)(*c*) to other employee option securities in respect of which the employee wishes to defer taxation under subsection 7(8).

In order for subsection 7(13) to apply, the employee must file a written revocation of the election with the person with whom the election was filed. Generally, the revocation request must be filed on or before January 15th of the year following the year in which the security was acquired. However, if the security was acquired in 2000, the filing deadline is extended to 60 days after the day on which the legislation providing for the revocation receives royal assent.

In being able to revoke an election, an employee has the ability to re-instate all or part of the $100,000 vesting limit for a particular year. This will be significant when the total specified value of securities that can be acquired under options vesting in that year exceeds $100,000.

Example

On April 30, 2001, Francine's corporate employer grants her options to acquire 10,000 shares of the company. The exercise price is $10 a share, which is the fair market value of the shares at that time. The options vest immediately and expire on April 30, 2005. On September 30, 2001, Francine's employer grants her options to acquire another 5,000 company shares. The exercise price is $15 a share, which is the fair market value of the shares at that time. The options vest immediately and expire on September 30, 2005.

Francine exercises all of the $10 options on April 30, 2005, when the fair market value is $100 a share. She files an election at that time to defer, under subsection 7(8), recognition of the employment benefit of $900,000 (= 10,000 x ($100 - $10)). Since the total specified value of the shares in respect of which the election is made is $100,000 (= 10,000 x $10), the election fully utilizes the deferral limit for the 2001 vesting year.

Francine exercises the remaining options on September 30, 2005, when the fair market value is $295 a share. She wishes to defer recognition of as much of the employment benefit of $1,400,000 (= 5,000 x ($295 - $15)) as possible. However, because of the previous election on the $10 options, she has no deferral room available. Since she needs $75,000 (= 5,000 x $15) of deferral room, she immediately files with the employer a written request to revoke the election previously made on 7,500 of the $10 options. This provides her with sufficient room to make an election to defer the employment benefit on all of the $15 options.

On Francine's T4 slip for 2005, the benefit of $675,000 associated with the 7,500 options on which the election was revoked is reported as employment income which is taxable in 2005. The remaining benefit of $1,625,000 (= 1/4 ($900,000) + $1,400,000)

is reported as a deferred amount, which is to be taxed in the year in which Francine disposes of the shares.

Deferral Deemed Valid

ITA
7(14)

New subsection 7(14) of the Act contains rules to allow the Minister of National Revenue to treat an invalid deferral of an employment benefit realized on the acquisition of an employee option security as a valid deferral under subsection 7(8).

Specifically, subsection 7(14) deals with situations in which an employee files an election to have an employment benefit deferred under subsection 7(8) but the conditions for the deferral are not satisfied. This could be because either the acquisition of the security in question was not a qualifying acquisition as defined in subsection 7(9) or the election was not made in accordance with subsection 7(10).

When this occurs, subsection 7(14) allows the Minister, upon so notifying the employee in writing, to treat the acquisition as having been a qualifying acquisition and to treat the election as having been made in accordance with subsection 7(10). If the employee still holds the security at the time the notice is sent, the employee is deemed to have disposed of the security at that time and to have reacquired the security immediately thereafter, but not under an employee option agreement. (The provision deeming a disposition and reacquisition of the security does not apply for purposes of the security-for-security exchange rules in subsection 7(1.5).)

In applying the provisions of subsection 7(14), the Minister can ensure that an employment benefit that was incorrectly treated as a deferred amount under subsection 7(8), and thus was not taxed in the year of acquisition, is taxable in the year in which the Minister sends the necessary notice or, if earlier, in the year in which the security is disposed of. It also ensures that the specified value of the security in question is applied against the employee's $100,000 vesting limit for the year in which the right to acquire the security first became exercisable.

It is expected that the Minister would apply the provisions of subsection 7(14) when the year in which the security was acquired is statute-barred.

Withholding

ITA
7(15)

New subsection 7(15) of the Act contains a special provision which has the effect of exempting employers from withholding and reporting obligations on employment benefits that employees are deemed, by paragraph 7(1)(*a*), to have received on the disposition of securities in respect of which a deferral was provided under subsection 7(8).

Under subsection 153(1) of the Act, an employer is required to withhold tax from an employee's remuneration and to remit that tax to the Receiver General on behalf of the employee and, under subsection 200(1) of the Regulations, the employer is required to report the remuneration to the Minister of National Revenue in an annual information return. Remuneration, for this purpose, would normally include any amount that the employee is deemed by paragraph 7(1)(*a*) to have received as a benefit from employment in connection with the acquisition of a security under an employee option agreement.

However, where the employment benefit is in respect of a security acquired under circumstances to which subsection 7(8) applied, subsection 7(15) deems the employment benefit to be nil for the purposes of subsection 153(1). Consequently, the employer has no obligation to withhold or remit tax, or to file an information return, in respect of the employment benefit recognized on the disposition of the security. The employee is, nevertheless, required to include the full amount of the benefit in computing employment income for the year in which the disposition occurs.

It should be noted that, under proposed subsection 200(5) of the Regulations, the employer will be required, in the year in which the employee acquires the security, to report the amount of the deferred employment benefit as a special item on the employee’s T4 slip. It should also be noted that, since the acquisition itself is not a taxable

event, it also does not give rise to any obligation on the part of the employer to withhold or remit tax on the amount of the deferred employment benefit. (See Appendix A for further details on the reporting requirements under proposed subsection 200(5).)

Prescribed Form for Deferral

ITA
7(16)

Under new subsection 7(16) of the Act, an employee who acquires securities under an employee option agreement, and elects to defer recognition of the related employment benefits under new subsection 7(8), is required to file a prescribed form, containing prescribed information, with the annual tax return for each year in which such securities are held.

Using this form, the employee will have to provide information on transactions relating to such securities, including acquisitions of new deferral securities and dispositions of existing deferral securities. This form will assist employees in complying with their obligations to include deferred employment benefits in computing employment income for the year in which there is a disposition of the related securities.

Clause 2

Income from Office or Employment – Deductions

ITA
8

Section 8 of the Act provides for the deduction of various amounts in computing income from an office or employment.

Clergy Residence Deduction

ITA
8(1)(*c*)

Paragraph 8(1)(*c*) of the Act allows certain members of the clergy or of religious orders, as well as certain regular ministers of religious denominations, to deduct an amount in respect of their living accommodation. To be eligible for the deduction, the individuals have to be in charge of, or ministering to, a diocese, parish or congregation, or engaged exclusively in full-time administrative service by a religious order or a religious denomination. The amount of the deduction depends upon whether the living accommodation they occupy is (a) supplied to them by virtue of their employment, (b) rented by them or (c) owned by them.

Where the living accommodation is supplied by virtue of the employment, the amount of the deduction is equal to the value of the benefit derived from the supply of the living accommodation, to the extent that the value is already included in income. Where the living accommodation is rented by the clergy person, the amount of the deduction is equal to the amount of rent paid. Where the living accommodation is owned by the clergy person, the deduction is equal to the fair rental value of the living accommodation. In the latter two cases, the amount of the deduction for a particular year cannot exceed the amount of the remuneration for the year.

This amendment to paragraph 8(1)(*c*) deals with living accommodations rented or owned by individuals who are otherwise eligible to the deduction under that paragraph. In these cases, it limits the amount of the deduction to the least of three amounts:

- the individual's remuneration for the year from the office or employment,

- the greater of

  - 1/3 of the individual's total remuneration from the employment for the year, and

- $1,000 per month (to a maximum of ten months) in the year during which an individual meets the conditions set out in subparagraphs 8(1)(*c*)(i) and (ii), and

• the fair rental value of the residence (reduced by the total of all other amounts deducted in computing an individual's income from a business or from an office or employment in connection with the same accommodation). This is relevant where, for example, two spouses who are members of the clergy occupy the same accommodation.

Certificate of Employer

ITA
8(10)

Subsection 8(10) of the Act provides that a deduction will not be allowed to an employee under certain provisions unless the employee files with the return of income a prescribed form signed by the employer to the effect that the employee met the requirements of the relevant provisions. The amendment to subsection 8(10) adds a reference to paragraph 8(1)(*c*) with respect to the requirements set out in subparagraphs 8(1)(*c*)(i) and (ii).

These amendments apply to the 2001 and subsequent taxation years.

Clause 3

Income Inclusions

ITA
12

Section 12 provides for the inclusion of various amounts in computing the income of a taxpayer from a business or property.

Bad Debts Recovered

ITA
12(1)(*i*.1)

Paragraph 12(1)(*i*.1) of the Act requires an inclusion in income in respect of amounts recovered on account of bad debts, where subsection 20(4.2) of the Act applied to permit a deduction, or an allowable capital loss in respect of the debt.

Paragraph 12(1)(*i*.1) is amended, consequential on the amendments to subsections 14(1) and 20(4.2) that reflect the reduced inclusion rate for capital gains, by replacing the fraction "3/4" with the fraction "1/2". It is also amended to reflect the restructuring of subsection 20(4.2) into subsection 20(4.2) (deduction) and 20(4.3) (deemed allowable capital loss). In addition, it is restructured as a formula to improve readability. The amount required to be included in income is 1/2 of the amount recovered multiplied by the ratio of the amount that was deducted under subsection 20(4.2) in respect of the debt to the total of the amount deducted under subsection 20(4.2) in respect of the debt and the amount deemed by subsection 20(4.3) (previously part of subsection 20(4.2)) to be an allowable capital loss in respect of the debt. Subsection 39(11) of the Act deems the portion of the recovered amount that relates to the allowable capital loss to be a taxable capital gain. That is, the amount by which 1/2 of the recovered debt exceeds the amount required to be included in income under paragraph 12(1)(*i*.1) is deemed to be a taxable capital gain.

For further details, see the commentary on the amendments to subsections 14(1) to (5), 20(4.2) and 39(11).

These amendments apply in respect of taxation years that end after February 27, 2000 except that, for taxation years that end after February 27, 2000 and before October 18, 2000, the fraction to be used in calculating the amount required to be included in income is 2/3 rather than 1/2.

Foreign Oil and Gas Production Expenses

ITA
12(1)(*o*.1)

Subsection 12(1) of the Act requires a taxpayer to include certain amounts, as income from a business or property, in computing the taxpayer's income for a taxation year. New paragraph 12(1)(*o*.1) ensures that any "production tax amount" of the taxpayer for a "foreign oil and gas business" is included in computing the taxpayer's income. Both of these terms are newly defined in subsection 126(7) of the Act, and are explained more fully in the notes to that provision.

New paragraph 12(1)(*o*.1) applies to taxation years that begin after 1999. However, in the event that a taxpayer elects to have the new foreign tax credit provisions in section 126 apply to taxation years that begin after a date (no earlier than December 31, 1994) designated by the taxpayer, new paragraph 12(1)(*o*.1) applies on the same basis.

Clause 4

Depreciable Property

ITA
13

Section 13 of the Act provides a number of special rules relating to the tax treatment of depreciable property. Generally, these rules apply for the purposes of sections 13 and 20 and the capital cost allowance regulations.

Rules Applicable

ITA
13(7)

Subsection 13(7) of the Act provides rules relating to capital cost that apply where there has been a change of use of depreciable property.

ITA
13(7)(*b*) and (*d*)

Paragraph 13(7)(*b*) of the Act determines the capital cost to a taxpayer of depreciable property originally acquired for a purpose other than gaining or producing income, where the taxpayer subsequently begins to use the property for the purpose of gaining or producing income.

Paragraph 13(7)(*d*) of the Act determines the capital cost of depreciable property where the use made of the property for the purposes of gaining or producing income changes relative to other uses made of the property. Subparagraph 13(7)(*d*)(i) applies where the income-producing use has increased relative to the other uses made of the property.

The amendments to clauses 13(7)(*b*)(i)(B) and 13(7)(*d*)(i)(B) replace the references to the fraction "3/4" with references to the fraction "1/2" and references to the expression "4/3 of" with references to the word "twice". The changes are consequential on the decrease of the inclusion rate for capital gains from 3/4 to 1/2.

These amendments generally apply to changes in use of property that occur in taxation years that end after February 27, 2000. For changes in use of property that occur in a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the references to the fraction "1/2" are to be read as references to the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year, and the references to the word "twice" are to be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*), of the Act that applies to the taxpayer for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

ITA
13(7)(*e*)

Paragraph 13(7)(*e*) of the Act contains special rules which apply to determine the capital cost of depreciable property where the property is acquired on a direct or indirect transfer between persons who do not deal at arm's length.

The amendments to paragraph 13(7)(*e*) replace the references to the fraction "3/4" with references to the fraction "1/2" and the references to the expression "4/3 of" with references to the word "twice". The changes are consequential to the decrease of the inclusion rate for capital gains from 3/4 to 1/2.

The amendments generally apply to acquisitions of property that occur in taxation years that end after February 27, 2000. For acquisitions of property that occur in a taxation year that includes either February 28, 2000 or October 17, 2000 of a person or partnership from whom the property was acquired, the references in paragraph 13(7)(*e*) to the fraction "1/2" are to be read as references to the fraction in amended paragraph 38(*a*) of the Act that applies to the person or partnership from whom the taxpayer acquired the property for the year in which such person or partnership disposed of the property. The references to the word "twice" are to be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the taxpayer for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

ITA
13(7)(*f*)(ii)

Paragraph 13(7)(*f*) of the Act applies to determine the capital cost of a property where a corporation is treated as having disposed of and reacquired depreciable property either under paragraph 111(4)(*e*) of the Act (on an acquisition of control of the corporation) or paragraph 149(10)(*b*) of the Act (where the corporation becomes or ceases to be exempt from tax under Part I of the Act on its taxable income).

The amendment to subparagraph 13(7)(*f*)(ii) replaces the fraction "3/4" with the fraction "1/2". The change is consequential to the decrease of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to acquisitions of property that occur in taxation years of a taxpayer that end after February 27, 2000 except that, for acquisitions of property that occur in a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the reference in subparagraph 13(7)(*f*)(ii) to the fraction "1/2" is to be read as a reference to the fraction in amended paragraph 38(*a*) of the

Act that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Disposition of Building

ITA
13(21.1)

Subsection 13(21.1) of the Act sets out rules that in certain cases adjust a taxpayer's proceeds of disposition in respect of land and buildings disposed of by the taxpayer.

The amendment to paragraph 13(21.1)(*b*) replaces the reference to the fraction "1/4" with a reference to the fraction "1/2", as a consequence of the decrease of the inclusion rate for capital gains and losses from 3/4 to 1/2.

The amendment applies to dispositions of property that occur in taxation years of a taxpayer that end after February 27, 2000 except that, for dispositions of property that occur in a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the references in paragraph 13(21)(*b*) to the fraction "1/2" is to be read as a reference to the fraction determined by subtracting the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year from 1. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 5

Eligible Capital Property

ITA
14

Section 14 provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of "eligible capital properties" and operates on a pooling basis. Annual deductions, which are calculated as a percentage of this pool, may be claimed under paragraph 20(1)(*b*). (These deductions are referred to in these notes as "depreciation"). Eligible capital property includes goodwill, customer lists, farm quotas and licenses of indeterminate duration.

The cost of eligible capital property is recognized, for income tax purposes, in a pool system similar to the capital cost allowance (CCA) system. Unlike CCA, however, only 3/4 of the cost is added to the pool, and only 3/4 of the proceeds of disposition of eligible capital properties is credited against the pool. Any negative balance at the end of a taxation year must be included in calculating income for the year and may be comprised of a portion analogous to recaptured CCA deductions and a portion analogous to a taxable capital gain, calculated at a 3/4 inclusion rate.

With the reduction in the capital gains inclusion rate to 2/3 announced in the February 2000 budget and to 1/2 announced in the October 2000 Economic Statement and Budget Update, only 8/9 or 2/3 of gains in respect of eligible capital property (subject to recapture of depreciation claimed) need be included in computing income. The existing 3/4 inclusion rate is, however, maintained for the purpose of calculating pool balances. The 8/9ths and 2/3rds factors effectively convert the 3/4 inclusion rate for gains to a 2/3 inclusion rate for taxation years that end after February 27, 2000 and before October 18, 2000 and to a 1/2 inclusion rate for taxation years that end after October 17, 2000.

Inclusion in Income from Business

ITA
14(1)

Subsection 14(1) of the Act requires certain amounts to be included in a taxpayer's income where, at the end of a taxation year, the amounts required to be deducted from a taxpayer's cumulative eligible capital pool (CEC pool) exceed the amounts required to be added to the CEC pool. Currently the amount required to be included in income is generally equal to the absolute value of any negative CEC pool balance (subject to adjustments related to the 1988 conversion of the pool from a 1/2 to a 3/4 inclusion rate, and to any exempt gains balance that the taxpayer retains in respect of an election regarding gains accrued to February 22, 1994 that can benefit from the capital gains exemption that existed until that time).

The current wording of subsection 14(1) generally provides one rule for individuals (existing paragraph 14(1)(*a*)) and a second rule for corporations. The amount that individuals must include in income is

divided into a recapture of depreciation previously claimed, described in subparagraph 14(1)(*a*)(iv), and any remaining negative CEC pool balance (subject to the adjustments described above) in excess of the subparagraph 14(1)(*a*)(iv) amount. This remaining amount is described in subparagraph 14(1)(*a*)(v), and can be considered as being analogous to a capital gain in respect of eligible capital property. Consistent with the change to the capital gains inclusion rate for all taxpayers, subsection 14(1) is amended to replace the two rules in paragraphs 14(1)(*a*) and (*b*) with one rule of general application.

Amended subsection 14(1) applies the previous rule for individuals to all taxpayers. The change reflects the new 1/2 inclusion rate for capital gains by reducing the second amount required to be included in income (generally the absolute value of the negative CEC pool balance, less any depreciation claimed that is required to be included in income under former subparagraph 14(1)(*a*)(iv) (now paragraph 14(1)(*a*)). The reduction is accomplished by multiplying the existing formula that describes the second amount by 2/3. The second amount has an inherent recognition of the 3/4 rate because it reflects additions to and subtractions from the CEC pool calculated at 3/4. Since 2/3 of 3/4 equals 1/2, the amendment provides and appropriate recognition of the reduction in the capital gains inclusion rate.

Example

Sophie has a cumulative eligible capital pool balance of $750,000 in 1999. This pool balance reflects $100,000 of depreciation claimed since Sophie began carrying on business in 1989. In January 2000, Sophie disposes of eligible capital property to Acme Corporation for proceeds of disposition of $2 million. Sophie claims no depreciation in 2000. Sophie has an exempt gains balance of $50,000, which she claims to reduce her paragraph 14(1)(b) income inclusion for 2000. Applying the amendments described above to section 14, the 2000 taxation year (December 31 year-end) results are as follows:

opening balance: $750,000

less 3/4 x $2 million proceeds of disposition

credit balance: (750,000)

recapture of depreciation claimed (amended paragraph 14(1)(a)): $100,000 income inclusion

residual income inclusion (amended paragraph 14(1)(b)): 2/3 x (A-B-C-D)

A is $750,000

B is $100,000 of depreciation

C (1/2 of depreciation claimed before adjustment time) is nil, and

D is $50,000.

2/3 x (750,000 - 100,000 - 50,000) = $400,000 income inclusion.

These amendments apply to taxation years that end after February 27, 2000 except that, for taxation years that end after February 27, 2000 and before October 18, 2000, the reference to 2/3 in the formula is to be read as a reference to 8/9.

Election re: Capital Gain

ITA
14(1.01)

The capital gains inclusion rate change is reflected in amendments to subsection 14(1) as described above. These amendments, however, only apply where a taxpayer has a negative CEC pool balance. The result of this is that additions to the CEC pool are still made at the 3/4 rate and dispositions of eligible capital property still reduce pool balances on a 3/4 basis as well.

There may be circumstances in which a taxpayer would prefer to recognize the entire economic capital gain on eligible capital property on a 1/2 or 2/3 basis, for example, if a taxpayer has outstanding capital losses to be used but wants to conserve the CEC pool balance.

New subsection 14(1.01) of the Act permits a taxpayer to elect to, in effect, remove a particular asset from the CEC pool and recognize a capital gain on the particular asset in the year as if it were ordinary non-depreciable capital property.

This election is only available to recognize gains, not losses, and is not available for goodwill or for other types of property for which the original cost cannot be determined. Further, it cannot be used to recognize a capital gain that can be sheltered by the taxpayer's exempt gains balance.

This amendment applies to taxation years that end after February 27, 2000.

Deemed Taxable Capital Gain

ITA
14(1.1)

Subsection 14(1.1) of the Act deems certain amounts included in an individual's income in respect of eligible capital property attributable to qualified farm property to be a taxable capital gain of the individual for the purpose of the capital gains exemption in section 110.6 of the Act. The amount deemed to be a taxable capital gain is limited to the lesser of two amounts. The first amount is the amount included in the taxpayer's income under subparagraph 14(1)(*a*)(v) (now paragraph 14(1)(*b*)). The second amount is the taxable amount of the taxpayer's cumulative net gains from dispositions in the year or in a preceding taxation year commencing after 1987 of qualified farm property that is eligible capital property in respect of the business, minus the amount of such taxable net gains that have already been deemed to be taxable capital gains (either under subsection 14(1.1), or under paragraph 14(1)(*a*) as it read in respect of fiscal periods that ended before February 23, 1994).

Subsection 14(1.1) is amended consequential on the amendments to subsection 14(1), to change references to subparagraph 14(1)(*a*)(v) to references to new paragraph 14(1)(*b*).

Subsection 14(1.1) is also amended to adjust the second amount described above to reflect the reduced inclusion rate for capital gains. In order to properly reflect the taxable portion of gains for different taxation years that begin after 1987, it is necessary to amend variable A in paragraph 14(1.1)(*b*) to limit the application of the 3/4 inclusion rate for proceeds of dispositions and associated acquisition and selling costs, to dispositions that occurred in taxation years that ended before February 28, 2000, and introduce the 2/3 inclusion rate in respect of

dispositions that occur in taxation years that end after February 27, 2000 and before October 18, 2000 and the 1/2 inclusion rate in respect of dispositions that occur in taxation years that end after October 17, 2000. Variable A now includes the taxable portion of net gains at the appropriate inclusion rates.

These amendments apply to taxation years that end after February 27, 2000.

Acquisition of Eligible Capital Property

ITA
14(3)

Subsection 14(3) of the Act provides rules regarding non-arm's length transfers of eligible capital property. In those circumstances, where the vendor has claimed a capital gains exemption under section 110.6 in respect of the disposition, the eligible capital expenditure of the purchaser is reduced in order to prevent the purchaser from depreciating amounts that were exempt from capital gains tax in the hands of the non-arm's length vendor.

Subsection 14(3) is amended, consequential on the amendments to subsection 14(1) that reflect the reduced inclusion rate for capital gains. Because subsection 14(3) reduces the purchaser's eligible capital expenditure, and because eligible capital expenditures are still added to the purchaser's cumulative eligible capital pool at a rate of 3/4, the appropriate fraction in subsection 14(3) remains 4/3 of the proceeds of disposition of the vendor. However, the amount available as a deduction in respect of capital gains under section 110.6 for taxation years that end after February 27, 2000 and before October 18, 2000 must be grossed up by 9/8, and by 3/2 for taxation years that end after October 17, 2000, to correct for the reduced inclusion rate and properly reflect the portion of the proceeds of disposition that has been sheltered from taxation. For further details, see the commentary on the amendments to subsection 14(1).

These amendments apply to taxation years that end after February 27, 2000.

Definitions

ITA
14(5)

Subsection 14(5) of the Act contains definitions that apply for the purpose of section 14, which deals with eligible capital property.

"cumulative eligible capital"

The definition "cumulative eligible capital" provides the calculation of a taxpayer's eligible capital property pool for the purpose of determining the taxpayer's allowable depreciation in respect of eligible capital property for the year.

Two amendments are proposed to the calculation of cumulative eligible capital:

1. Variable B in the cumulative eligible capital formula is an add-back for amounts previously included in income under subsection 14(1). Variable B is amended to gross up (by 3/2 and 9/8) the amount to be included in respect of income inclusions under paragraph 14(1)(*b*). This reflects the continued calculation of the cumulative eligible capital pool on a 3/4 basis, and converts the 1/2-based amount now included under paragraph 14(1)(*b*) (or the 2/3-based amount for taxation years that end after February 27, 2000 and before October 18, 2000) to a 3/4-based amount. Other amendments to variable B are consequential on the amendments to, and re-numbering of, subsection 14(1), which are described in further detail above.

2. Variable R, which is a component of variable F, is amended to update the reference to subparagraph 14(1)(*a*)(iv) by adding a reference to amended paragraph 14(1)(*a*), consequential on the re-numbering of subsection 14(1), which is described in further detail above.

These amendments apply to taxation years that end after February 27, 2000.

Clause 6

Income from Business or Property

ITA
18

Section 18 of the Act prohibits the deduction of certain outlays and expenses in computing a taxpayer's income from a business or property.

Costs Relating to Construction of Building or Ownership of Land

ITA
18(3.1)(*b*)

Subsection 18(3.1) of the Act denies the immediate deduction of certain costs, generally referred to as construction period soft costs, relating to the construction, renovation or alteration of a building. These costs are required to be added to the cost or capital cost of the building to which they relate.

This amendment to paragraph 18(3.1)(*b*), which is consequential on the enactment of new section 20.3 dealing with weak currency debt, ensures that the amount of an outlay or expense relating to construction period soft costs is only included in the cost or capital cost of the relevant building to the extent that the amount would otherwise be deductible in computing the taxpayer's income.

This amendment applies to outlays and expenses made or incurred after Announcement Date.

Thin Capitalization

ITA
18(4)

Subsection 18(4) of the Act provides thin capitalization rules for corporations resident in Canada, which limit their deduction for interest on debt owing to certain specified non-residents. The interest is disallowed where the corporation's debt-equity ratio in relation to the specified non-residents exceeds 3 to 1.

Pursuant to changes announced in the 2000 Budget, subsection 18(4) is amended in three ways. First, the debt-equity ratio is changed from the present 3:1 to 2:1, effective for taxation years that begin after 2000.

Second, the method of calculating debt for the debt-equity ratio is modified, effective for taxation years that begin after 2000. Under amended paragraph 18(4)(*a*), debt is calculated based on a monthly average. This average is calculated by first noting, for each calendar month that ends in a given taxation year, the greatest total amount of the corporation's debt outstanding to specified non-residents at any time in that month. The sum of these amounts is then divided by the number of calendar months that end in the taxation year to arrive at the monthly average debt.

Third, the method of calculating equity for the debt-equity ratio is also modified, effective for taxation years that begin after 2000. While the corporation's retained earnings continue to be calculated at the beginning of the year under amended paragraph 18(4)(*a*), monthly averages are provided for calculating the corporation's contributed surplus and paid-up capital. The monthly average contributed surplus is calculated by first noting, for each calendar month that ends in a given taxation year, the amount of the corporation's contributed surplus at the beginning of that month, to the extent that it was contributed by a specified non-resident shareholder of the corporation. The sum of these amounts is then divided by the number of calendar months that end in the taxation year to arrive at the monthly average contributed surplus. A similar calculation is provided for determining the corporation's paid-up capital for the purpose of the debt-equity ratio.

ITA
18(8)

Subsection 18(8) of the Act exempts from the application of the thin capitalization rules contained in subsection 18(4) corporations whose principal business in Canada throughout the year is the development or manufacturing of aircraft or aircraft components. Pursuant to changes announced in the 2000 Budget, this exemption is repealed, effective for taxation years that begin after 2000.

Clause 7

Income From Business or Property

ITA
20

Section 20 of the Act provides rules relating to the deductibility of certain outlays, expenses and other amounts in computing a taxpayer's income from a business or property.

Cumulative Eligible Capital Amount

ITA
20(1)(*b*)

Paragraph 20(1)(*b*) of the Act provides a deduction in calculating a taxpayer's income from a business of up to 7% of the taxpayer's cumulative eligible capital pool. Consequential on the examination of the eligible capital property provisions undertaken after the 2000 budget, paragraph 20(1)(*b*) is amended to introduce a short taxation year rule for eligible capital property.

This amendment applies to taxation years that begin after Announcement Date.

ITA
20(1)(*f*)(ii)

Paragraph 20(1)(*f*) of the Act sets out rules concerning the deductibility of amounts paid by a taxpayer where the amounts paid are in respect of the principal amount of an obligation that was issued for less than its principal amount.

The amendment to subparagraph 20(1)(*f*)(ii) replaces the reference the fraction "3/4" with a reference to the fraction "1/2", as a consequence of the change of the inclusion rate for capital gains from 3/4 to 1/2. The amendment applies in respect of amounts paid after February 27, 2000 except that, for amounts paid after February 27, 2000 and before October 18, 2000 the reference to the fraction "1/2" is to be read as a reference to the fraction "2/3". These modifications are required in order to reflect the capital gains/losses rate for the year.

ITA
20(1)(*z*.1)

Paragraph 20(1)(*z*.1) of the Act permits a taxpayer to deduct an amount in respect of amounts paid by the taxpayer to a lessee for the cancellation of a lease of a property where the property was not owned at the end of the year by the taxpayer or a non-arm's length person.

The amendment to paragraph 20(1)(*z*.1) replaces the reference to the fraction "3/4" with a reference to the fraction "1/2", as a consequence of the change of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies in respect of amounts paid after February 27, 2000 except that for amounts paid after February 27, 2000 and before October 18, 2000 the reference to the fraction "1/2" is to be read as a reference to the fraction "2/3". These modifications are required in order to reflect the capital gains/losses rate for the year.

Deduction for Inducements or Assistance

ITA
20(1)(*hh*)

Subparagraph 20(1)(*hh*)(i) of the Act provides a deduction for the repayment by a taxpayer of certain amounts that were included in the taxpayer's income under paragraph 12(1)(*x*) as an inducement or assistance. Subparagraph 20(1)(*hh*)(ii) provides a deduction for the repayment of certain inducements or assistance not included in the taxpayer's income under paragraph 12(1)(*x*) but that would have been so included but for the application of subparagraph 12(1)(*x*)(v.1) or subsection 12(2.2) of the Act which allow the netting of the amounts against other costs. Subparagraph 20(1)(*hh*)(ii) does not apply if the outlays or expenses related to the inducements or assistance were deductible in computing income under any of sections 66, 66.1, 66.2 or 66.4 (or would have been so deductible if certain limits on deductions under those sections were not taken into account).

Subparagraph 20(1)(*hh*)(ii) is amended so that repayments in respect of outlays or expenses deductible under new section 66.21 are likewise not deductible as a consequence of the application of that subparagraph. This amendment is consequential on the introduction

of new rules for the deduction of foreign resource expenses in section 66.21.

This amendment applies to taxation years that begin after 2000.

ITA
20(4.2) and (4.3)

Subsection 20(4.2) of the Act provides a deduction in computing income of a taxpayer for a bad debt on account of proceeds of disposition of eligible capital property. The deduction is reduced to the extent that the taxpayer has sheltered an income inclusion in respect of eligible capital property using the capital gains exemption in section 110.6, or the taxpayer's exempt gains balance (as defined by subsection 14(5)) in respect of the former $100,000 lifetime capital gains exemption. The amount of the reduction is deemed to be an allowable capital loss. The exempt gains balance is available only to individuals. (In these notes, deductions claimed under paragraph 20(1)(*b*) are referred to as "depreciation".)

Subsection 20(4.2) is amended consequential on the amendments to subsection 14(1) that reflect the reduced inclusion rate for capital gains. For further detail regarding the amendments to subsection 14(1), see the commentary to that provision. Because the eligible capital property system now incorporates three fractions, one for calculating cumulative eligible capital pool balance (3/4) and two others for calculating income inclusions under subsection 14(1), (2/3 and 1/2, subject to a recapture of depreciation claimed), the amendments to subsection 20(4.2) recognize three different proportions of bad debts as deductible, depending on how the recognition of the proceeds of disposition originally affected the taxpayer. The amount deductible under subsection 20(4.2) in respect of bad debts is determined by the formula (A + B) - (C + D + E + F + G + H). The formula operates as a pool that takes into account bad debts in the year and in preceding years.

Variable A applies for taxation years that end after February 27, 2000. It is equal to the lesser of 1/2 of total bad debts and, generally, the taxpayer's income inclusion under amended paragraph 14(1)(*b*), which reflects the taxable portion of the taxpayer's gain in respect of eligible capital property. The taxpayer's income inclusion under paragraph 14(1)(*b*) reflects the 2/3 or the 1/2 inclusion rate for capital

gains. Variable B is the amount by which 3/4 of the bad debt exceeds 9/8 or 3/2 of variable A. This ensures that only the appropriate fraction of the bad debt is recognized. Multiplying A by 9/8 or 3/2 converts it from a 2/3- or 1/2-based amount to a 3/4-based amount.

Variables C through H reduce the amount of the taxpayer's deduction to reflect otherwise taxable amounts that have been sheltered by deductions in respect of capital gains. Variables F and G relate to the taxpayer's claim in respect of his or her exempt gains balance, related to the $100,000 lifetime capital gains exemption, as defined in subsection 14(5). Variables F and G are only relevant for individuals. Variables C, D and E describe amounts that have been sheltered by the deduction under section 110.6 in respect of capital gains on qualified farm property. Variable H reduces the deduction by amounts deducted under the provision for prior years, to appropriately adjust the pool, which reflects all bad debts owing to the taxpayer in respect of eligible capital property.

Variables C to G are used to calculate the taxpayer's allowable capital loss under new subsection 20(4.3) as described below.

Example

(The first part of this example is also set out in the commentary to the amendments to subsection 14(1).)

Sophie has a cumulative eligible capital pool balance of $750,000 in 1999. This pool balance reflects $100,000 of depreciation claimed since Sophie began carrying on business in 1989. In January 2000, Sophie disposes of eligible capital property to Acme Corporation for proceeds of disposition of $2 million. Sophie claims no depreciation in 2000. Sophie has an exempt gains balance of $50,000, which she claims to reduce her paragraph 14(1)(b) income inclusion for 2000. Applying the proposed amendments to section 14 described above, the 2000 taxation year results are as follows:

opening balance: $750,000

less 3/4 x $2 million proceeds of disposition

credit balance: ($750,000)

recapture of depreciation claimed (amended paragraph 14(1)(a)): $100,000 income inclusion

residual income inclusion (amended paragraph 14(1)(b)): 2/3 x (A-B-C-D)

A is $750,000

B is $100,000 of depreciation

C (1/2 of depreciation claimed before adjustment time) is nil, and

D is $50,000 (exempt gains balance that Sophie is claiming).

2/3 x ($750,000 - $100,000 - $50,000) = $400,000 income inclusion.

In 2001, the $2 million owed to Sophie becomes a bad debt when Acme Corporation goes bankrupt.

Sophie applies amended subsections 20(4.2) and (4.3) to calculate her deduction and allowable capital loss in respect of the bad debt.

<u>*Deduction*</u> *((A + B) - (C + D + E + F + G + H)).*

A is the lesser of

> *(a) 1/2 of the bad debt, plus 1/2 of bad debts from prior years -- $1,000,000, and*
>
> *(b) the paragraph 14(1)(b) amount, read without reference to variable D in the 14(1)(b) formula: 2/3 x ($750,000 - $100,000) = $433,333*

the lesser of (a) and (b) is $433,333

B is the amount by which 3/4 of the bad debt, plus 3/4 of the bad debts from prior years – $1.5 million – exceeds 3/2 of the amount determined for A: 3/2 x $433,333 = $650,000

B is \$1.5 million - \$650,000 = \$850,000

(A + B) is \$433,333 + \$850,000 = \$1,283,333

C is nil, because Sophie has not claimed a deduction under section 110.6 in respect of capital gains related to an income inclusion under subsection 14(1) or (1.1)

F(a) is 2/3 of the exempt gains balance that Sophie claimed. 2/3 of \$50,000 is \$33,333.

D, E, F(b) and G are generally the same as C and F(a), except that they apply in respect of taxation years that ended before February 28, 2000 or taxation years that ended after February 27, 2000 and before October 18, 2000. Sophie has not claimed a deduction in respect of capital gains, or claimed anything in respect of her exempt gains balance, for taxation years that ended before February 28, 2000 nor for taxation years that ended after February 27, 2000 and before October 18, 2000.

H is nil because Sophie has not claimed an amount under subsection (4.2) for bad debts in prior years.

The calculation set out in subsection 20(4.2) therefore allows Sophie a deduction of \$1,283,333 - \$33,333 = \$1,250,000. This deduction corresponds to Sophie's \$400,000 income inclusion under paragraph 14(1)(b), plus her recaptured depreciation of \$100,000, plus the elimination of her \$750,000 pool balance; these three amounts total \$1,250,000.

Sophie used her exempt gains balance of \$50,000 in the 2000 taxation year sale of eligible capital property to shelter a portion of the gain. The \$33,333 determined by variable F(a) reduces Sophie's deduction as described above in recognition of this sheltering. The amount of the reduction is \$33,333, rather than \$50,000, because the new formula for the calculation of Sophie's 2000 taxation year (December 31 year-end) income inclusion under paragraph 14(1)(b) introduces the factor 2/3 to the calculation. (In other words, \$33,333 will shelter the same amount of gain under a 1/2 inclusion rate system as \$50,000 did under a 3/4 inclusion rate system. In both cases \$66,667 can be sheltered.) The amount of the reduction in variable F(a) is deemed by

subsection 20(4.3) to be an allowable capital loss, as described below.

The additional rule set out in existing paragraphs 20(4.2)(*b*), (*c*) and the "postamble" (which provides that the reduction of the deduction to recognize untaxed capital gains is deemed to be an allowable capital loss) are being moved to new subsection 20(4.3).

New subsection 20(4.3) of the Act provides that where a taxpayer's deduction under subsection 20(4.2) is reduced to recognize the taxpayer's use of a capital gains deduction to offset an income inclusion under subsection 14, the taxpayer is deemed to have an allowable capital loss. The allowable capital loss, in effect, restores the capital gains deduction that was used up in sheltering a gain on what turned out to be a bad debt. The allowable capital loss is equal to the lesser of two amounts. The first amount is 1/2 of the total bad debts. The second amount is the capital gains exemption amounts or exempt gains balance used up in respect of dispositions of eligible capital property under the 1/2 inclusion rate system, plus 3/4 of capital gains exemption or exempt gains balance used up in respect of dispositions of eligible capital property under the 2/3 inclusion rate system plus 2/3 of capital gains exemption or exempt gains balance used up in respect of dispositions of eligible capital property under the 3/4 inclusion rate system. The use of the fraction 3/4 converts the 2/3-based exemption claims to a 1/2 basis for the purpose of calculating an allowable capital loss that will be used to offset capital gains that are included at 1/2. The fraction 2/3 converts the 3/4-based exemption claims to the same rate basis.

These amendments apply in respect of taxation years that end after February 27, 2000 except that, for taxation years that end after February 27, 2000 and before October 18, 2000, the fractions used will be adjusted to reflect a 2/3 inclusion rate. In particular, the references to 1/2, 3/2 and 2/3 are to be read as references to 2/3, 9/8 and 8/9, respectively, and subparagraph 20(4.3)(*b*)(ii) is to be read without the expression "3/4 of".

Clause 8

Weak Currency Debt

ITA
20.3

New section 20.3 of the Act limits the deductibility of interest expenses and adjusts foreign exchange gains and losses in respect of weak currency debts and associated hedging transactions.

Where a currency is weak, in that it is expected to decline in value relative to a reference currency, the interest rate on a loan in the weak currency will generally be higher than on a loan on similar terms in the reference currency. The higher rate reflects the market's expectation that the amount of the loan expressed in the weak currency will be worth less in terms of the reference currency when the loan is repaid. Lenders generally demand a higher interest rate to compensate for this expected depreciation. If, as expected, the weak currency depreciates, the borrower will realize a foreign exchange gain when the principal of the loan is repaid in the depreciated foreign currency. In economic terms, this gain compensates for the higher interest payments made during the term of the loan. Hedging transactions may be used to fix the reference currency cost of the interest and principal payments that are required to be made in the weak currency.

To ensure certainty, new section 20.3 sets out specific rules concerning the taxation of weak currency debts to the debtor.

Interpretation

ITA
20.3(1)

New subsection 20.3(1) of the Act defines several terms that are used in section 20.3, which limits the deductibility of interest expense in respect of weak currency debts.

"exchange date"

Under paragraph 20.3(2)(*a*) of the Act, the limitation on deductibility of interest in respect of a weak currency debt (also defined in subsection 20.3(1)) applies as of the "exchange date" in respect of the debt. This expression is defined in two ways reflecting two different circumstances. If the weak currency debt is incurred or assumed by the taxpayer in respect of borrowed money denominated in the final currency (defined within the definition "weak currency debt"), the exchange date is the day the debt was assumed or incurred. On the other hand, if the debt is incurred or assumed in respect of borrowed money that is not denominated in the final currency, or in respect of the acquisition of property, the exchange date is the day on which the taxpayer uses the borrowed money or the acquired property, directly or indirectly, to acquire funds or settle an obligation denominated in the final currency. Thus, where the taxpayer holds the borrowed funds or acquired property for a period of time before using them to acquire funds, or settle an obligation, in a different currency, the interest limitation rule does not apply until that initial conversion takes place. The use of the phrase "directly or indirectly" is intended to cause the exchange date to be the date of the first such conversion in currency, even if the initial conversion is an intermediate step to a subsequent conversion into the final currency.

"hedge"

The expression "hedge" is defined in respect of a weak currency debt as any agreement that can reasonably be regarded as having been entered into by the taxpayer primarily to reduce the risk of fluctuations in the value of the weak currency, relative to the final currency of use or some other currency of reference such as Canadian currency, in respect of interest or principal payments on the debt.

It is contemplated that hedges could be in a variety of legal forms such as forward and futures contracts, options, swaps and long positions in assets denominated in foreign currency. A hedge need not eliminate all risk associated with currency exposure in a weak currency debt; a contract that serves to reduce risks only partially is included.

In order to be treated as a hedge for the purposes of section 20.3, an agreement must also be identified by the taxpayer as a hedge in

respect of the particular weak currency debt in a designation filed with the Minister of National Revenue within 30 days of the taxpayer entering into the hedge agreement. This requirement for up-front identification of the hedge is designed to eliminate any incentive to report or not report the existence of a hedge based on hindsight regarding its performance.

While this definition generally applies to taxation years that end after February 27, 2000, for hedge agreements entered into prior to July 2000, a hedge designation is considered timely if it is filed on or before the later of July 31, 2000 and the 30th day after the day the taxpayer agrees to the hedge.

"weak currency debt"

A "weak currency debt" is defined as a debt denominated in a foreign currency – the weak currency – that is incurred or assumed by the taxpayer after February 27, 2000 in respect of either a borrowing of money or an acquisition of property and that meets a number of other conditions set out in the three paragraphs of the definition.

Paragraph (*a*) of the definition sets out several alternative conditions, of which one must be met, linking the weak currency to another currency – referred to as the "final currency" – used directly for earning income. The final currency is defined with respect to whichever of these conditions is met. Each subparagraph requires that in order to constitute the final currency, the associated funds must be used, or the associated obligation be incurred or assumed, for the purpose of earning income and not to acquire funds in a different currency. This ensures that if the transaction involves conversion into an intermediate currency or currencies before conversion to the currency employed in the direct income-earning use, only the last currency, directly used for earning income, is considered the "final currency".

The three alternatives are as follows:

(i) The borrowed money advanced by the lender is in the final currency but the taxpayer is obliged to repay the debt in the weak currency.

(ii) The taxpayer uses the borrowed money or acquired property, directly or indirectly, to acquire funds in the final currency. This condition encompasses cases where the weak currency is exchanged into one or more other currencies as an intermediate step prior to being exchanged into the final currency. An example involving property would be the purchase of a commodity on credit where the debt for the unpaid purchase price is denominated in the weak currency and the commodity is subsequently sold for proceeds denominated in the final currency, or sold for proceeds that are used to purchase funds in the final currency.

(iii) The taxpayer uses the borrowed money or acquired property, directly or indirectly, to settle an obligation in the final currency.

Paragraph (*b*) of the definition specifies that, to be considered a weak currency debt, a debt must be of an amount exceeding $500,000. In determining whether this threshold is met, the debt is combined with any other weak currency debts (that is, debts that would be weak currency debts but for the $500,000 threshold) that were incurred or assumed by the taxpayer as part of a series of transactions. This ensures, for example, that the rules cannot be avoided by structuring a weak currency borrowing as a series of smaller borrowings each of which is exempt because it is below the size threshold.

Paragraph (*c*) of the definition provides that a debt is only considered a weak currency debt if the interest rate in the weak currency is more than two percentage points (200 basis points) higher than the interest rate that would have obtained in the final currency if the taxpayer had incurred an equivalent amount of debt in the final currency on the same terms, other than the rate of interest. For this purpose, terms other than the interest rate may be varied, but only to the extent required to accommodate the currency difference – e.g. where comparable debt markets in the two currencies have different conventions as to interest payment dates.

New subsection 20.3(1) applies to taxation years that end after February 27, 2000.

Interest and Gain

ITA
20.3(2)

New subsection 20.3(2) of the Act sets out several substantive rules that apply to a taxpayer that is a debtor in respect of a weak currency debt. These rules do not apply to a corporation that is a bank, trust company, credit union or a corporation whose principal business is lending money at arm's length.

Paragraph 20.3(2)(*a*) limits the amount that may be deducted on account of interest expense in respect of a weak currency debt to the amount that would have been deductible under the Act if the taxpayer had instead incurred or assumed an equivalent amount of debt in the final currency (defined within the definition "weak currency debt" in subsection 20.3(1)) on the same terms (other than the rate of interest). Under the Act, the deductible interest on such a final currency borrowing could not exceed a reasonable amount, generally determined based on market interest rates in the final currency on debts negotiated at the same time and on the same terms as the weak currency debt. Thus, if a taxpayer borrows in a weak currency and converts the proceeds into another currency – the final currency – for use to earn income, the interest deduction for any particular period is limited to the amount that would have been deductible for that period if the taxpayer had instead borrowed directly, and paid interest, in the final currency.

The limitation in paragraph 20.3(2)(*a*) applies with respect to interest that accrues on a weak currency debt after the later of June 30, 2000 and the exchange date (defined in subsection 20.3(1)) in respect of the debt.

Paragraph 20.3(2)(*b*) provides that any foreign exchange gain or loss on the settlement or extinguishment of the weak currency debt, or on the performance or settlement of any hedge (defined in subsection 20.3(1)) in respect of the debt, is on income account. Regardless of whether the debt itself is considered to be on capital or income account, it is considered appropriate to treat the foreign currency gains or losses on income account, since foreign exchange gains and losses anticipated by the market will typically be reflected in interest rates and the Act allows deductibility of interest expense. For

symmetry, a hedge in respect of the exchange rate movements that produce such gains and losses is also treated as being on income account.

Paragraph 20.3(2)(*c*) provides that, for the purpose of computing the taxpayer's foreign exchange gain or loss on the settlement or extinguishment of a weak currency debt, any interest expense for which a deduction is denied by new subsection 20.3 is deemed to be an amount paid by the taxpayer to settle or extinguish the debt. This rule ensures that the amount of denied interest reduces the amount of any foreign exchange gain on settlement and increases the amount of any foreign exchange loss on settlement. In economic terms, the higher interest cost of the weak currency debt is generally expected to be offset by a foreign exchange gain on maturity. Since deductibility of the excess interest cost is denied under paragraph 20.3(2)(*a*), it is considered appropriate to reduce the amount of the foreign exchange gain (or increases the amount of the foreign exchange loss) for tax purposes in recognition that the expected gain or loss can be viewed as compensation for the excess interest expense.

New subsection 20.3(2) applies to taxation years that end after February 27, 2000.

Hedges

ITA
20.3(3)

New subsection 20.3(3) of the Act indicates how the rules in subsection 20.3(2) are to be applied when a taxpayer has entered into a hedge (defined in subsection 20.3(1)) in respect of a weak currency debt. In applying those rules, the amount (which under the Act is measured in Canadian dollars) paid or payable in the weak currency on account of interest or principal on the debt is decreased by the amount of any foreign exchange gain, or increased by the amount of any foreign exchange loss, on the hedge in respect of the amount so paid or payable. This ensures that in applying the rules in subsection 20.3(2), the hedge is integrated with the weak currency debt.

Thus, with respect to interest expenses, it is the taxpayer's net interest cost incorporating hedge gains or losses that is taken into account rather than the interest cost based solely on the current Canadian

dollar value of the interest amounts paid or payable. Likewise, with respect to principal payments, it is the net amount repaid incorporating hedge gains or losses that is taken into account rather than solely the current Canadian dollar value of the principal amount paid.

New subsection 20.3(3) applies to taxation years that end after February 27, 2000.

Repayment of Principal

ITA
20.3(4)

New subsection 20.3(4) of the Act deals with repayments and other reductions in principal owing under a weak currency debt. If the principal amount outstanding (expressed in the weak currency) is reduced before maturity, the amount of the reduction is deemed to have been a separate debt from the time the debt was incurred or assumed by the taxpayer. This ensures that the rules in section 20.3 will operate on each portion of the debt. Thus, for example, paragraph 20.3(2)(*a*) will limit the amount of interest deductible in respect of a particular portion of the debt based on a comparison with the interest that would have been deductible if an amount equivalent to the particular portion had been borrowed in the final currency. The operation of the rule in respect of the particular portion will not be affected by the repayment of another portion of the principal.

The separate debt rule does not apply for the purpose of determining the rate of interest that would have been charged in the final currency. This ensures that the comparable final currency interest rate is the one that would apply to a borrowing of the entire original amount of the principal, not the rate that would apply to a separate borrowing of a portion of that amount, which might be a higher rate due to a loss of economies of scale. Similarly, the $500,000 threshold in paragraph (*b*) of the definition "weak currency debt" in subsection 20.3(1) is applied to the entire principal amount and not to any portion of it segregated by the deeming rule.

Subsection 20.3(4) applies to taxation years that end after February 27, 2000.

Clause 9

Borrowed Money Used for Exploration and Development

ITA
21(2) and (4)

Subsections 21(2) and (4) of the Act apply where a taxpayer has used borrowed money for the purpose of incurring specified resource expenses. Where the taxpayer so elects, financing costs in respect of the borrowed money are not deductible under any of paragraphs 20(1)(*c*) to (*e*.1) in computing the taxpayer's income. Instead, except where the deduction under one of those paragraphs relates to exempt income (as defined in subsection 248(1)), those costs are added to the category of resource expenses that the borrowed money was used to incur. The election under subsection 21(2) is made in connection with financing costs incurred in the taxation year during which the related resource expenses were incurred. Elections under subsection 21(4) are made in connection with financing costs incurred after that year, and can only be made for a taxation year if treatment under section 21 has been chosen for all preceding taxation years with regard to the borrowed money to which the financing costs related.

Subsections 21(2) and (4) are amended so that the exception referred to above for exempt income extends to all income that is exempt from tax under Part I of the Act. This amendment is made for consistency with proposed paragraph (*l*) of the definition "investment tax credit" in subsection 127(9) and ensures that subsections 21(2) and (4) cannot be used by entities exempt from tax under subsection 149(1).

Subsections 21(2) and (4) are also amended so that the resource expenses specified under those subsections include foreign resource expenses (as defined in the definition "foreign resource expense" in new section 66.21), determined on a country-by-country basis. This amendment is consequential on the introduction of new rules in section 66.21 for the deduction of foreign resource expenses.

These amendments apply to taxation years that begin after 2000.

Clause 10

Business Carried on by Spouse, Common-Law Partner or Corporation

ITA
24(2)(*d*)

Subsection 24(2) of the Act provides a rollover of the cumulative eligible capital of a business of an individual who ceases to carry on the business in circumstances where the eligible capital property of the business is acquired by the individual's spouse or common-law partner or by a corporation controlled by the individual that thereafter carries on the business.

Paragraph 24(2)(*d*) deals with the calculation of income inclusions under subsection 14(1) for the spouse, common-law partner or corporation. Paragraph 24(2)(*d*) is amended consequential on the re-numbering of subsection 14(1), which is described in further detail above.

These amendments apply to taxation years that end after February 27, 2000.

Clause 11

Prospectors and Grubstakers

ITA
35

Section 35 of the Act applies where:

- a share of the capital stock of a corporation is received by a taxpayer, and

- as detailed in paragraphs 35(1)(*a*) and (*b*), the consideration is "mining property" (as defined in subsection 35(2)) that is linked with prospecting or exploring.

Where section 35 applies, paragraph 35(1)(*c*) provides that the receipt of the share does not result in any immediate income inclusion. Other rules in subsection 35(1) govern the tax consequences resulting from the disposition of the share and the acquisition of the mining property.

The definition "mining property" in subsection 35(2) is amended so that it extends only to minerals in a mineral resource in Canada. "Mineral resource" is defined in subsection 248(1). This amendment is consequential on the introduction of new section 66.21, which deals with foreign resource expenses.

This section applies to shares received after Announcement Date.

Clause 12

Scientific Research and Experimental Development

ITA
37(1)

Section 37 of the Act sets out the rules governing the deductibility of expenditures incurred by a taxpayer for scientific research and experimental development (SR&ED).

Under subsection 37(1), certain expenditures incurred by taxpayer for SR&ED carried on in Canada are accumulated in a SR&ED pool. All or a portion of the undeducted balance of the pool at the end of a taxation year may be deducted in that year. Any remaining balance of the pool at the end of a taxation year may be carried forward to be deducted in a subsequent taxation year.

New paragraph 37(1)(*d*.1) provides for the reduction of a corporation's SR&ED pool for a taxation year by its super-allowance benefit amount (a new expression defined in subsection 127(9) of the Act) for the year and preceding taxation years.

This amendment applies to taxation years that begin after February 2000 except that, for corporations whose first taxation year that begins after February 2000 ends before 2001, this amendment applies to taxation years that begin after 2000.

Clause 13

Taxable Capital Gain and Allowable Capital Loss

ITA
38

Section 38 of the Act defines a taxpayer's taxable capital gain, allowable capital loss and business investment loss from the disposition of property as 3/4 of the taxpayer's capital gain, capital loss or business investment loss from the disposition. The section is amended as a consequence of the changes to the inclusion rates for capital gains and losses from 3/4 to 1/2.

ITA
38(*a*), (*b*) and (*c*)

See page 267 for commentary on paragraphs 38(*a*.1) and (*a*.2).

Paragraph 38(*a*) is also amended to add a reference to new paragraph 38(*a*.2), which provides that the inclusion rate in respect of qualifying gifts of ecologically sensitive land is 1/4.

These amendments apply to the 2000 and subsequent taxation years with the following exceptions.

In order to determine the inclusion rate for a taxation year of a taxpayer that ends before February 28, 2000, the references to the fraction "1/2" in paragraphs 38(*a*), (*b*) and (*c*) are to be read as references to the fraction "3/4". These modifications are required in order to reflect the capital gains/losses rate for the year.

For a taxation year of a taxpayer that includes February 28, 2000 but does not include October 18, 2000, the references to the fraction "1/2" in paragraphs 38(*a*), (*b*) and (*c*) are to be read as references to the fraction that applies to the taxpayer for that year, determined as follows:

- where the amount of the taxpayer's net capital gains from dispositions of property in the period that begins at the beginning of the year and ends at the end of February 27, 2000 (the first period) exceeds the amount of the taxpayer's net

capital losses from dispositions of property in the period that begins at the beginning of February 28, 2000 and ends at the end of the year (the second period), the fraction that applies to the taxpayer for the year is 3/4;

- where the amount of the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 3/4;

- where the amount of the taxpayer's net capital gains from dispositions of property in the first period is less than the amount of the taxpayer's net capital losses from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3;

- where the amount of the taxpayer's net capital losses from dispositions of property in the first period is less than the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3;

- where the taxpayer has only net capital gains or only net capital losses from dispositions of property in each of both the first and second periods, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(3/4\ A + 2/3\ B) / (A+B)$$

where

A is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the first period, and

B is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the second period; and

- where the net capital gains and net capital losses of the taxpayer for the year are nil, the fraction that applies to the taxpayer for the year is 2/3.

For a taxation year of a taxpayer that begins after February 27, 2000 and includes October 18, 2000, in order to determine the inclusion rate for the year the references to the fraction "1/2" in paragraphs 38(*a*), (*b*) and (*c*) are to be read as references to the fraction that applies to the taxpayer for that year, determined as follows:

- where the amount of the taxpayer's net capital gains from dispositions of property in the period that begins at the beginning of the year and ends at the end of October 17, 2000 (the first period) exceeds the amount of the taxpayer's net capital losses from dispositions of property in the period that begins at the beginning of October 18, 2000 and ends at the end of the year (the second period), the fraction that applies to the taxpayer for the year is 2/3;

- where the amount of the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3;

- where the amount of the taxpayer's net capital gains from dispositions of property in the first period is less than the amount of the taxpayer's net capital losses from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 1/2;

- where the amount of the taxpayer's net capital losses from dispositions of property in the first period is less than the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 1/2;

- where the taxpayer has only net capital gains or only net capital losses from dispositions of property in each of both the first and second periods, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(2/3\ A + 1/2\ B)\ /\ (A+B)$$

where

A is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the first period, and

B is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the second period and;

- where the net capital gains and net capital losses of the taxpayer for the year are nil, the fraction that applies to the taxpayer for the year is 1/2,

For a taxation year of a taxpayer that includes February 27, 2000 and October 18, 2000, in order to determine the inclusion rate for the year the references to the fraction "1/2" in paragraphs 38(*a*), (*b*) and (*c*) are to be read as references to the fraction that applies to the taxpayer for that year, determined as follows:

- where

  – the amount by which the taxpayer's net capital gains from dispositions of property in the period that begins at the beginning of the year and ends at the end of February 27, 2000 (the first period) exceeds the amount of the taxpayer's net capital losses from dispositions of property in the period that begins at the beginning of February 28, 2000 and ends at the end of October 17, 2000 (the second period)

  exceeds

  – the amount of the taxpayer's net capital losses from dispositions of property in the period that begins at the beginning of October 18, 2000 and ends at the end of the year (the third period),

  the fraction that applies to the taxpayer for the year is 3/4;

- where

  - the amount by which the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period

  exceeds

  - the amount of the taxpayer's net capital gains from dispositions of property in the third period

  the fraction that applies to the taxpayer for the year is 3/4;

- where

  - the amount by which the taxpayer's net capital gains from dispositions of property in the second period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the first period

  exceeds

  - the amount of the taxpayer's net capital losses from dispositions of property in the third period

  the fraction that applies to the taxpayer for the year is 2/3;

- where

  - the amount by which the taxpayer's net capital losses from dispositions of property in the second period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the first period

  exceeds

  - the amount of the taxpayer's net capital gains from dispositions of property in the third period

  the fraction that applies to the taxpayer for the year is 2/3;

- where the taxpayer has net capital gains in the first and second periods and the aggregate of the amount of those net capital gains exceeds the amount of the taxpayer's net capital losses in the third period, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

  $$(3/4\ A + 2/3\ B) / (A+B)$$

  where

  A is the net capital gains of the taxpayer from dispositions of property in the first period, and

  B is the net capital gains of the taxpayer from dispositions of property in the second period;

- where the taxpayer has net capital losses in the first and second periods and the aggregate of the amount of those net capital losses exceeds the amount of the taxpayer's net capital gains in the third period, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

  $$(3/4\ A + 2/3\ B) / (A+B)$$

  where

  A is the net capital losses of the taxpayer from dispositions of property in the first period, and

  B is the net capital losses of the taxpayer from dispositions of property in the second period;

- where the taxpayer has only net gains, or only net capital losses, from dispositions of property in each the first, the second and the third periods, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

  $$(3/4\ A + 2/3\ B + 1/2C) / (A+B+C)$$

where

A is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the first period,

B is the net capital gains or the net capital losses as the case may be, of the taxpayer from dispositions of property in the second period, and

C is the net capital gains or the net capital losses as the case may be, of the taxpayer from dispositions of property in the third period;

- where the amount of the taxpayer's net capital gains from dispositions of property in the first period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the second period and the taxpayer has net capital gains from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(3/4\ A + 1/2\ B) / (A+B)$$

where

A is the amount by which the taxpayer's net capital gains from dispositions of property in the first period exceeds the amount of the taxpayer’s net capital losses from dispositions of property in the second period, and

B is the taxpayer's net capital gains from dispositions of property in the third period;

- where the amount of the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer’s net capital gains from dispositions of property in the second period and the taxpayer has net capital losses from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(3/4\ A + 1/2\ B) / (A+B)$$

where

A is the amount by which the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period, and

B is the taxpayer's net capital losses from dispositions of property in the third period;

- where the amount of the taxpayer's net capital gains from dispositions of property in the second period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the first period and the taxpayer has net capital gains from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(2/3\ A + 1/2\ B) / (A+B)$$

where

A is the amount by which the taxpayer's net capital gains from dispositions of property in the second period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the first period, and

B is the taxpayer's net capital gains from dispositions of property in the third period;

- where the amount of the taxpayer's net capital losses from dispositions of property in the second period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the first period and the taxpayer has net capital losses from dispositions of property in the third period, the fraction that applies to the taxpayer for the year is the fraction determined by the formula

$$(2/3\ A + 1/2\ B) / (A+B)$$

where

A is the amount by which the taxpayer's net capital losses from dispositions of property in the second period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the first period, and

B is the taxpayer's net capital losses from dispositions of property in the third period; and

- in any other case, the fraction that applies to the taxpayer for the year is 1/2.

For the purpose of determining the inclusion rate that applies to the taxpayer for the year, the following assumptions are to be made:

- The net capital gains of a taxpayer from dispositions of property in a period is the amount by which the taxpayer's capital gains from dispositions of property in the period exceeds the taxpayer's capital losses from dispositions of property in the period.

- The net capital losses of a taxpayer from dispositions of property in a period is the amount by which the taxpayer's capital losses from dispositions of property in the period exceeds the taxpayer's capital gains from dispositions of property in the period.

- The net amount included as a capital gain of the taxpayer for a taxation year from a disposition of ecological property or from a disposition to which paragraph 38(*a*.1) of the Act applies is one half of the capital gain.

- The net amount included in a capital gain of the taxpayer for a taxation year because of subparagraphs 40(1)(*a*)(ii) and (iii) of the Act is a capital gain of the taxpayer from a disposition of property on the first day of the year.

- Each capital loss that is a business investment loss is determined without reference to subsection 39(9) and 39(10) of the Act.

- Where an amount is included in computing the income of the taxpayer for the year because of subsection 80(13) of the Act in respect of a commercial obligation that is settled, the amount that would be determined under that subsection in respect of the obligation, if the value of E in the formula in that subsection were 1, is a capital gain of the taxpayer from a disposition of property on the day on which the settlement occurred.

- The taxpayer's capital gains and losses from dispositions of property (other than taxable Canadian property) that occur at a time when the taxpayer is a non-resident, are nil.

- Where an election is made by a taxpayer under amended paragraph 104(21.4)(*d*) or subsections 130.1(4.3) or 131(1.6) of the Act for the year, the portion of the net gains of the taxpayer for the year that are to be treated as being in respect of capital gains realized on dispositions of property that occurred in a particular period in the year is that proportion of the net gains that the number of days in that period is of the number of days that are in the year.

- Where the election made under amended paragraph 104(21.4)(*d*) of the Act for the year was made by a personal trust, the portion of the taxpayer's net gains for the year that are to be treated as being in respect of capital gains realized on dispositions of property that occurred in a particular period in the year is that proportion of those net gains that the number of days in the particular period is of the number of days that are in all periods in the year in which a net gains was realized.

- Where, in the course of administering the estate of a deceased taxpayer, a capital loss from disposition of property by the legal representative of a deceased taxpayer is deemed under paragraph 164(6)(*c*) of the Act to be a capital loss of the deceased taxpayer from the disposition of property by the taxpayer in the taxpayer's last taxation year and not to be capital losses of the estate, the capital loss is from the disposition of property by the taxpayer immediately before the taxpayer's death.

- Each capital gain referred to in amended paragraph 104(21.4)(*a*) of the Act in respect of a beneficiary, is to be determined as if that paragraph were read without reference to subparagraph (ii) thereof.

- Where no capital gains or losses are realized in a period, the amount of net capital gains or losses for that period is nil.

- Where a net amount is included as a capital gain of the taxpayer for a taxation year because of the granting of an option under subsection 49(1) of the Act, the net amount is a capital gain of the taxpayer from a disposition of property on the day on which the option was granted.

- Where a net amount is included as a capital gain of a corporation for its taxation year under subsection 49(2) of the Act because of the expiration of an option that was granted by the corporation, the net amount is a capital gain of the corporation from a disposition of property on the day on which the option expired.

- Where a net amount is included as a capital gain of a trust for its taxation year under subsection 49(2.1) of the Act because of the expiration of an option that was granted by the trust, the net amount is a capital gain of the trust from a disposition of property on the day on which the option expired.

- Where a net amount is included in respect of an option as a capital gain of a taxpayer for a taxation year because of subsection 49(3), 49(3.01) or 49(3.1) of the Act, the net amount is a capital gain of the taxpayer from a disposition of property on the day on which the option was exercised.

- Where an amount is included in the income of the taxpayer for the year because of property sold subject to an earn-out agreement, the taxpayer has a capital gain from a disposition of property on the day on which a payment was received under the agreement.

Gift to Qualified Donnee

ITA
38(*a*.1)

Paragraph 38(*a*.1) of the Act provides a special inclusion rate for capital gains arising as a result of a gift of certain securities to qualified donees. This inclusion rate is one half of the normal inclusion rate.

The amendment to paragraph 38(*a*.1) replaces the reference to the fraction "3/8" (one-half of 3/4) with a reference to the fraction "1/4" (one-half of 1/2).

The amendment applies to the 2000 and subsequent taxation years except that,

(a) for a taxation year of a taxpayer that includes February 28, 2000 or October 17, 2000, the reference to the fraction "1/4" in paragraph 38(*a*.1) is to be read as a reference to 1/2 of the fraction in amended paragraph 38(*a*) that applies to the taxpayer for the year and,

(b) for a taxation year that ends before February 28, 2000 the reference to the fraction "1/4" in paragraph 38(*a*.1) is to be read as a reference to the fraction "3/8".

Ecological Gifts

ITA
38(*a*.2)

The portion of a taxpayer's capital gain that is required to be included in computing income is his or her "taxable capital gain". New paragraph 38(*a*.2) of the Act provides that if a capital gain results from the making of an ecological gift to a qualified donee, only 1/4 of the gain will be a taxable capital gain and hence included in income. The definitions of "ecological gifts" and "total ecological gifts" in paragraph 110.1(1)(*d*) and subsection 118.1(1) respectively are also amended to provide that the fair market value of such gifts must be certified by the Minister of the Environment. For further detail, see the commentary on section 118.1.

This amendment applies to gifts made after February 27, 2000, except that if the taxpayer's taxation year begins after February 28, 2000 and ends before October 17, 2000, the reference to the fraction "1/4" is to be read as a reference to "1/3", and if the taxpayer's taxation year includes either February 28, 2000 or October 17, 2000, the capital gains inclusion rate will be one half of the rate otherwise calculated for the year under amended paragraph 38(*a*) of the Act.

Clause 14

Deduction from Business Investment Loss

ITA
39(9)(*b*)(i.1) to (i.2)

Pursuant to subsection 39(9) of the Act, in computing a business investment loss a taxpayer is required to deduct, from the amount of the business investment loss otherwise determined, the lesser of the amount of the business investment loss and the taxpayer's net capital gains for which a deduction was claimed under section 110.6 of the Act, to the extent that such gains have not been used to reduce other business investment losses.

In calculating the net capital gains for which a deduction was claimed under section 110.6, such deductions are grossed-up by the reciprocal of the applicable inclusion rate.

Consequential on the change of the inclusion rate for capital gains from 3/4 to 1/2, subparagraphs 39(9)(*b*)(i) to (i.2) are amended to provide for a reduction in a business investment loss of

- twice the amounts deducted by the taxpayer under section 110.6 for taxation years that ended prior to 1988 or begin after October 17, 2000,
- 3/2 of such amounts deducted for 1988, 1989 and taxation years that begin after February 27, 2000 and end before October 18, 2000,
- 4/3 of such amounts deducted for taxation years that ended after 1989 and before February 28, 2000, and

- an amount equal to the product obtained when the reciprocal of the taxpayer's inclusion rate (the fraction in amended paragraph 38(*a*) that applies to the taxpayer) for each of the taxpayer's taxation years that include February 28, 2000, or October 18, 2000 is multiplied by amounts deducted under section 110.6 for that taxation year.

These amendments apply to taxation years that end after February 27, 2000.

ITA
39(10)(*b*)(i) to (i.2)

Pursuant to subsection 39(10) of the Act, in computing a business investment loss of a trust, the trust is required to deduct from the amount of the business investment loss otherwise determined, the lesser of

- the amount of the business investment loss, and

- the amount by which the trust's capital gains exceeds capital losses (net gains) – to the extent that the net taxable capital gains derived from those net gains were the subject of a designation under subsection 104(21.2) of the Act in respect of a beneficiary and those net gains have not been used to reduce other business investment losses.

In calculating the net gains required to reduce the business investment loss, amounts designated in respect of beneficiaries under subsection 104(21.2) are grossed-up by the reciprocal of the applicable inclusion rate (the fraction that applies to the trust in amended paragraph 38(*a*)) of the trust.

Consequential on the change of the inclusion rate for capital gains from 3/4 to 1/2, subparagraphs 39(10)(*b*)(i) to (i.2) are amended to provide for a reduction in a business investment loss of a trust of

- twice the amounts designated by the trust under subsection 104(21.2) for taxation years that ended prior to 1988 and begin after October 17, 2000,

- 3/2 of such amounts designated for 1988, 1989 and taxation years that begin after February 27, 2000 and end before October 18, 2000,

- 4/3 of such amounts designated for taxation years that ended after 1989 and before February 28, 2000, and

- an amount equal to the product obtained when the reciprocal of the trust inclusion rate (for each of the trust's taxation years that include February 28, 2000 or October 18, 2000) is multiplied by the amounts designated by the trust under subsection 104(21.2) in respect of a beneficiary for that taxation year.

These amendments apply to taxation years that end after February 27, 2000.

Recovery of Bad Debt

ITA
39(11)

Subsection 39(11) of the Act deems a portion of a recovered bad debt in respect of eligible capital property to be a taxable capital gain. The portion that is deemed to be a taxable capital gain is the amount that relates to the portion of the bad debt that was previously deemed by subsection 20(4.2) (now by subsection 20(4.3) of the Act) to be an allowable capital loss. For further detail, see the commentary to subsections 20(4.2) and (4.3).

Subsection 39(11) is amended consequential on the change to the inclusion rate for capital gains, by replacing the fraction "3/4" with the fraction "1/2".

This amendment applies in respect of taxation years that end after February 27, 2000 except that, for taxation years that end after February 27, 2000 and before October 18, 2000, the fraction to be used in calculating the deemed taxable capital gain is 2/3 rather than 1/2.

Clause 15

Exempt Capital Gains Balance in Respect of Flow-Through Entity

Definitions

ITA
39.1(1) "exempt capital gains balance"

The exempt capital gains balance of an individual for a taxation year in respect of a flow-through entity represents the unclaimed balance of the capital gains that were included in computing the individual's income as a result of an election made under subsection 110.6(19) of the Act to crystallize accrued capital gains in respect of the individual's interest in or shares of the capital stock of the entity.

Where an election is made under subsection 110.6(19), the amount of the gain realized as a result of the election does not affect the adjusted cost base of the property but is instead credited to the exempt capital gains balance account of the taxpayer in respect of the taxpayer's interest in or share of the flow-through entity.

The description of C of the formula in the definition "exempt capital gains balance" in subsection 39.1(1) represents the total of amounts deducted in previous taxation years in respect of capital gains flowed out to the taxpayer from the flow-through entity which had been sheltered under any of subsections 39.1(3) through (5).

The amendments to the description of C in the definition are strictly consequential on the change in the capital gains inclusion rate from 3/4 to 1/2.

Amended paragraph (*a*) of the description of C in the definition "exempt capital gains balance" requires a reduction of a taxpayer's exempt capital gains balance in respect of a trust by

- 3/2 of the amount by which taxable capital gains from a designation under subsection 104(21) of the Act in respect of the taxpayer were reduced under subsection 39.1(3) for taxation years that began after February 27, 2000 and ended before October 18, 2000,

- 4/3 of the amounts by which taxable capital gains from a designation under subsection 104(21) in respect of the taxpayer were reduced under subsection 39.1(3) for taxation years that ended before February 27, 2000,

- the amount claimed by the individual for a preceding taxation year under amended subparagraph 104(21.4)(*a*)(ii), and

- twice the total of all amounts each of which is the amount by which the individual's taxable capital gain (determined without reference to section 39), for a preceding taxation year that began after October 17, 2000 that resulted from a designation made under subsection 104(21) by the trust was reduced by reason of subsection 39.1(3) in the taxation year.

Amended paragraph (*b*) of the description of C in the definition "exempt capital gains balance" requires a reduction in a taxpayer's exempt capital gains balance in respect of a partnership by

- 3/2 of the amount by which the taxpayer's share of taxable capital gains and income of the partnership were reduced under subsections 39.1(4) and (5) for taxation years that began after February 27, 2000 and ended before October 18, 2000,

- 4/3 of the amount by which the taxpayer's share of taxable capital gains and income of the partnership were reduced under subsections 39.1(4) and (5) for taxation years that ended before February 28, 2000, and

- the product obtained when the reciprocal of the fraction in amended paragraph 38(*a*) that applies to the partnership for the fiscal period of the partnership that includes either February 28, 2000 or October 17, 2000 is multiplied by the total of all amounts by which the taxpayer's share of taxable capital gains and income from the partnership were reduced under subsections 39.1(4) and (5) in the taxation year.

These amendments apply to taxation years that end after February 27, 2000.

Reduction of Capital Gain

ITA
39.1(2)

Subsection 39.1(2) of the Act allows an individual with an exempt capital gains balance in respect of a flow through entity to claim a reduction in the capital gain otherwise determined for a taxation year from a subsequent disposition of an interest in or share of the capital stock of the flow-through entity. The reduction is limited to the individual's exempt capital gains balance for the year in respect of the entity.

Paragraphs (*a*) and (*b*) of the description of B in subsection 39.1(2) are amended to replace the reference to the expression "4/3 of" with a reference to the word "twice". The amendment is consequential on the reduction in the capital gains inclusion rate from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, where the taxation year of an entity that ends in the taxation year of the taxpayer includes either February 28, 2000 or October 17, 2000, the references to the word "twice" in paragraphs (*a*) and (*b*) of the description of B in subsection 39.1(2) are to be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the entity for its taxation year that ends in the taxpayer's taxation year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Reduction of Taxable Capital Gain

ITA
39.1(3)

Subsection 104(21) of the Act provides a flow-through mechanism for taxable capital gains of trusts. Where a trust makes a designation under that subsection in respect of a beneficiary, the designated amount is treated as a taxable capital gain of the beneficiary. Subsection 39.1(3) of the Act allows an individual to claim a reduction in the amount of the taxpayer's taxable capital gain otherwise determined for a taxation year as a result of a designation under subsection 104(21) by a flow-through entity. The reduction is

limited to 3/4 of the individual's exempt capital gains balance for the year in respect of the entity.

Subsection 39.1(3) is amended to replace the reference to the fraction "3/4" with a reference to the fraction "1/2". The amendment is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, where the taxation year of an entity that ends in the taxation year of the taxpayer includes either February 28, 2000 or October 17, 2000, the reference in the subsection 39.1(3) to that fraction is to be read as a reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the entity for its taxation year that ends in the taxpayer's taxation year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Reduction in Share of Partnership's Taxable Capital Gains

ITA
39.1(4)

A member of a partnership is taxed on his or her share of the income of the partnership for its fiscal period that ends in the member's taxation year. For this purpose, taxable capital gains at the partnership level are treated as taxable capital gains of its members to the extent of their respective shares thereof. Subsection 39.1(4) of the Act allows an individual to claim a reduction in the individual's share of a partnership's taxable capital gains for a fiscal period that ends in the individual's taxation year. The reduction is limited to 3/4 of the individual's exempt capital gains balance for the year in respect of the partnership.

As a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2, the fraction "3/4" in the description of A in subsection 39.1(4) is replaced by the fraction "1/2".

The amendment applies to taxation years that end after February 27, 2000 except that, where the taxation year of an entity that ends in the taxation year of taxpayer includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" is to be read as

reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the entity for its taxation year that ends in the taxpayer's taxation year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Reduction in Share of Partnership's Income from a Business

ITA
39.1(5)(*a*)

Subsection 39.1(5) of the Act allows an individual who is a member of a partnership to shelter, with his or her exempt capital gains balance in respect of the partnership, that part of his or her share of the partnership's income from a business that is attributable to an amount included under subparagraph 14(1)(*a*)(v) of the Act in computing the partnership's income from the business.

Paragraph 39.1(5)(*a*) is amended to replace the fraction "3/4" with the fraction "1/2". The amendment is consequential to the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, where the taxation year of an entity that ends in a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in paragraph 39.1(5)(*a*) is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the entity for its taxation year that ends in the taxpayer's taxation year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 16

Taxable Net Gain from Disposition of Listed Personal Property

ITA
41(1)

Subsection 41(1) of the Act defines a taxpayer's taxable net gain for a taxation year from dispositions of listed personal property as 3/4 of

the taxpayer's net gain determined under subsection 41(2) from dispositions of such property.

Subsection 41(1) is amended to replace the reference to the fraction "3/4" with a reference to the fraction "1/2". The amendment is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in subsection 41(1) is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 17

Capital Gains Deferral – Eligible Small Business Investments

ITA
Section 44.1

New section 44.1 of the Act permits an individual to defer, in certain circumstances, the recognition for income tax purposes of all or a portion of a capital gain arising on a disposition of an eligible small business investment.

This new section applies to disposition that occur after February 27, 2000.

Definitions

ITA
44.1(1)

New subsection 44.1(1) of the Act defines terms used in section 44.1.

"ACB reduction"

The term "ACB reduction" is relevant for the purpose of new paragraph 44.1(2)(*b*). An individual's ACB reduction in respect of a replacement share of an individual in respect of a qualifying disposition is determined as that proportion of the permitted deferral of the individual in respect of the qualifying disposition that the qualifying cost to the individual of the replacement share is of the qualifying cost to the individual of all replacement shares. The ACB reduction reduces the adjusted cost base to the individual of the replacement share under paragraph 44.1(2)(*b*) and subparagraph 53(2)(*b*)(i) of the Act.

"active business corporation"

The term "active business corporation" is relevant for the purposes of the term "qualifying disposition" and new subsection 44.1(6). An active business corporation at any time is a taxable Canadian corporation all or substantially all of the fair market value of the assets of which, at that time, is attributable to assets of the corporation that are

- used principally in an active business carried on by the corporation or by an active business corporation related to it,

- shares or debt of other active business corporations related to the corporation, or

- a combination of those types of assets.

Pursuant to new subsection 44.1(10), a professional corporation, a specified financial institution, a corporation that the principal business of which is the leasing, rental, development of sale or any combination thereof of real property owned by it, or a corporation that more than 50 per cent of the fair market value of the property of which is attributable to real property are excluded from this definition.

"carrying value"

The term "carrying value" is relevant for the purpose of the term "eligible small business corporation share". The carrying value of the

assets of a corporation at any time is the amount at which its assets would be valued for the purpose of its balance sheet if that balance sheet were prepared in accordance with generally accepted accounting principles used in Canada. An exception is that an asset of the corporation that is a share or a debt issued by a related corporation is deemed to have a carrying value of nil.

"common share"

The term "common share" is relevant for the purposes of the definition "eligible small business corporation share" and new subsection 44.1(7) of the Act. A common share is a share prescribed by subsection 6204(1) of the *Income Tax Regulations* for the purpose of paragraph 110(1)(*d*) of the Act.

"eligible pooling arrangement"

The term "eligible pooling arrangement" is relevant for the purpose of new subsection 44.1(3) of the Act. An eligible pooling arrangement is an agreement in writing made between an individual and another person or partnership (the investment manager) where the terms and conditions of the agreement provide

- for the transfer of funds or other property by the individual to the investment manager,

- the use of the funds or proceeds from the sale of the property by the investment manager to purchase eligible small business corporation shares on behalf of the individual within 60 days of the receipt of the funds or property, and

- a monthly reporting to the individual by the investment manager of the securities transactions made on behalf of the individual.

"eligible small business corporation"

The term "eligible small business corporation" is relevant for the purposes of the term "eligible small business corporation share". An eligible small business corporation, at a particular time, means a Canadian-controlled private corporation all or substantially all of the fair market value of the assets of which is, at that time, attributable to assets of the corporation that are

- assets used principally in an active business carried on primarily in Canada by the corporation or an eligible small business corporation related to it,

- shares of or debt issued by other eligible small business corporations related to the corporation, or

- a combination of those two types of assets.

An exception is that an asset of the corporation that is a share or a debt issued by a related corporation is deemed to have a carrying value of nil.

"eligible small business corporation share"

The term "eligible small business corporation share" of an individual is relevant for the purposes of the term "qualifying disposition" of an individual and new subsections 44.1(6) and (7) of the Act. An eligible small business corporation share of an individual is a common share issued by a corporation to the individual where at the time the share is issued the corporation was an eligible small business corporation and immediately before and after that time it's the total carrying value carrying value of its assets and the assets of corporations related to it does not exceed $50 million.

"permitted deferral"

An individual's "permitted deferral" in respect of a qualifying disposition is the amount of a capital gain from the disposition that can be deferred. It reduces the gain otherwise determined of the individual for the qualifying disposition. It is determined as that portion of the qualifying portion of the capital gain of the individual from a qualifying disposition of the individual that the total of the qualifying cost to the individual of replacement shares in respect of the disposition is of the qualifying proceeds of disposition of the individual in respect of the disposition.

"qualifying cost"

The term "qualifying cost" of an individual of replacement shares of the individual in respect of a particular qualifying disposition of the individual is relevant in computing the individual's permitted deferral

in respect of the qualifying disposition. The qualifying cost is the lesser of two amounts. The first is the cost of the replacement shares issued by the particular eligible small business corporation. The second is the amount by which $2,000,000 exceeds the total of the cost of all other replacement shares in respect of other qualifying dispositions of the individual at or before the time of the qualifying disposition that were shares of the particular eligible small business corporation or an eligible small business corporation related to it at the time the share was acquired.

"qualifying disposition"

The term "qualifying disposition" of an individual is relevant for the purposes of the term "permitted deferral" and subsection 44.1(2) of the Act. An individual can have a capital gain deferral only in respect a gain arising on a qualifying disposition of the individual. A qualifying disposition of an individual is a disposition of common shares of the capital stock of a corporation owned by the individual where each such share was a an eligible small business corporation share of the individual, was a common share of the capital stock of an active business corporation throughout the time it was owned by the individual and was owned by the individual throughout the 185-day period that ended immediately before the disposition. Pursuant to new subsection 44.1(9), the active business of the corporation referred to in the definition "active business corporation" has to be carried on primarily in Canada, at all times in the period that began when the individual last acquired the share and ended when the disposition occurred (the "ownership period"), if that period is less than 730 days. In any other case that active business has to be carried on primarily in Canada for at least 730 days during the ownership period.

"qualifying portion of a capital gain"

The term "qualifying portion of a capital gain" of an individual from a qualifying disposition of the individual is relevant for the purpose of the term "permitted deferral". An individual's portion of a capital gain from a particular qualifying disposition of shares of the capital stock of a particular eligible small business corporation is determined as that proportion the capital gain (determined without reference to section 44.1) of the individual from that disposition that can be attributed to the amount of adjusted cost base of shares disposed of

that does not exceed the $2,000,000 investment limit. This amount of adjusted cost base is determined by reference to the adjusted cost bases of shares (determined without reference to new section 44.1) of the particular corporation or corporations related to it disposed of in qualifying dispositions of the individual at or before the time of the particular qualifying disposition.

For example, if the individual had a capital gain from a particular qualifying disposition in which the individual sold shares with a total adjusted cost base of $3,000,000, because of the $2,000,000 investment limit, only 2/3 of the gain otherwise determined would be included in the qualifying portion of the capital gain.

"qualifying portion of the proceeds of disposition"

The term "qualifying portion of the proceeds of disposition" of an individual from a qualifying disposition is relevant for the purposes of the term "permitted deferral". It is determined by multiplying the individual's proceeds of disposition by the fraction that is determined by dividing the individual's qualifying portion of the capital gain from the disposition by the individual's capital gain from the disposition determined without reference to section 44.1. The individual's qualifying portion of the proceeds of disposition represents the maximum amount that the individual can include as the qualifying cost of replacement shares when calculating the permitted deferral of the individual in respect of the qualifying disposition.

"replacement share"

The term "replacement share" of an individual is relevant for the purposes of the term "permitted deferral". A replacement share of an individual in respect of a particular qualifying disposition of the individual in a taxation year means an eligible small business corporation share that was designated by the individual in the individual's return of income to be a replacement share of the individual in respect of the qualifying disposition and that was acquired by the individual within the year or within 60 days after the year but no later than 120 days after the qualifying disposition.

Capital Gain Deferral

ITA
44.1(2)

New subsection 44.1(2) of the Act permits an individual that has a capital gain, determined without reference to section 44.1, from a qualifying disposition in a taxation year to claim the permitted deferral of the individual in determining the individual's capital gain for the year from the disposition. Where the individual has a permitted deferral in respect of a qualifying disposition, the capital gain from the disposition is deemed to be the amount by which the individual's capital gain (determined without reference to section 44.1) exceeds the permitted deferral. The individual can establish a permitted deferral less than the maximum amount available by designating a lesser amount of replacement shares.

Under the subsection, the adjusted cost base to the individual, determined without reference to section 44.1, of the replacement shares of the individual in respect of the disposition is reduced by the amount of the individual's ACB reduction in respect of such replacement shares.

Special Rule – Eligible Pooling Arrangements

ITA
44.1(3)

New subsection 44.1(3) of the Act provides that any transaction entered into by an investment manager on behalf of an individual under an eligible pooling arrangement is deemed to be a transaction of the individual and not a transaction of the investment manager, except for the purpose of the definition "eligible pooling arrangement".

Special Rule – Acquisitions on Death

ITA
44.1(4)

New subsection 44.1(4) of the Act provides a special rule in cases where eligible small business corporation shares are acquired by an

individual as a consequence of the death of a person who is a spouse, common-law partner or a parent of the individual. Where subsection 70(6) or 70(9.2) of the Act applies to the individual in respect of such shares, the individual shall, for the purposes of section 44.1, be deemed to have acquired and owned the shares when they were acquired and owned by the spouse, common-law partner or parent. This rule permits the individual to be in the same position to claim a permitted deferral as the spouse, common-law partner or parent in respect of a capital gain arising on the disposition of such shares.

Special Rule – Breakdown of Relationships

ITA
44.1(5)

New subsection 44.1(5) of the Act provides a special rule in cases where eligible small business corporation shares of a former spouse or common-law partner of an individual are acquired by the individual as the consequence of the settlement of rights arising out of their marriage or common-law partnership. Where subsection 73(1) applied to the individual in respect of such shares, the individual is, for the purposes of section 44.1, deemed to have acquired and owned the shares when they were acquired and owned by the former spouse or common-law partner. This rule puts the individual in the same position to claim a permitted deferral as the former spouse or common-law partner in respect of a capital gain arising on the disposition of such shares.

Special Rule – Eligible Small Business Corporation Share Exchanges

ITA
44.1(6)

New subsection 44.1(6) of the Act provides special rules where an individual exchanges an eligible small business corporation share for new eligible small business corporation shares and the only consideration received on the exchange is the new eligible small business corporation shares. Where the individual's proceeds of disposition of the exchanged shares equals the adjusted cost base to the individual of the exchanged shares and paragraph 85(1)(*g*) or subsection 85.1(3) or 87(4) of the Act applies to the individual in

respect of the new shares, the new shares are deemed to have been owned by the individual throughout the period that the exchanged shares were owned by the individual. The individual's eligibility to claim a permitted deferral with respect to a gain arising on a disposition of the exchanged shares is rolled over to new shares.

Special Rule – Active Business Corporation Share Exchanges

ITA
44.1(7)

New subsection 44.1(7) of the Act provides special rules where an individual, in a qualifying disposition, disposes of common shares of an active business corporation for consideration consisting only of new common shares of another active business corporation issued to the individual. Where the individual's proceeds of disposition for the exchanged shares equals the individual's adjusted cost base of those shares and paragraph 85(1)(*g*) or subsection 85.1(3) or 87(4) of the Act applies to the individual in respect of the new shares, the new shares are deemed to be eligible small business shares of the individual that were owned by the individual throughout the period that the exchanged shares were owned by the individual and the new shares are deemed to be shares of an active business corporation that were owned by the individual throughout the period that the exchanged shares were owned by the individual. In effect, the individual's eligibility to claim a permitted deferral with respect to a capital gain arising on a disposition of the exchanged shares is rolled over to new shares.

Special Rule – Carrying On an Active Business

ITA
44.1(8)

New subsection 44.1(8) of the Act is relevant in determining whether a property held by a corporation is considered to be used or held in the course of carrying on an active business (active business property). Property held by a corporation at any particular time will be treated as active business property where that property or property for which that property is substituted property (special purpose property) was acquired by the corporation because it issued a debt or a share of a class of its capital stock, it disposed of property used or

held in the course of carrying on an active business or it accumulated its active business earnings in order to acquire money for the purpose of acquiring property to be used in or held in the course of or making expenditures for the purpose of earning income from an active business carried on by the corporation. This rule will apply only where the corporation carries on an active business and the property was acquired within 36 months after the particular time.

Special Rule – Qualifying Disposition

ITA
44.1(9)

New subsection 44.1(9) of the Act is relevant in determining whether a disposition is a qualifying disposition. A disposition of a common share of an active business corporation by an individual that would otherwise be a qualifying disposition is deemed not to be a qualifying disposition unless the active business of the corporation referred to in paragraph (*a*) of the definition "active business corporation" was carried on primarily in Canada, at all times in the period that began when the individual last acquired the share and ended when the disposition occurred (the "ownership period"), if that period is less than 730 days. In any other case that active business has to be carried on primarily in Canada for at least 730 days during the ownership period.

Special Rule – Exceptions

ITA
44.1(10)

New subsection 44.1(10) of the Act is relevant in determining whether a corporation can qualify as an eligible small business corporation or as an active business corporation. A professional corporation, a specified financial institution, a corporation that the principal business of which is the leasing, rental, development of sale or any combination thereof of real property owned by it, or a corporation more than 50 per cent of the fair market value of the property of which is attributable to real property cannot qualify as an eligible small business corporation or as an active business corporation.

Determination Rule

ITA
44.1(11)

New subsection 44.1(11) of the Act is relevant in determining whether a share is an eligible small business corporation share of an individual for the purpose of section 48.1 of the Act.

Section 48.1 permits a taxpayer, under certain circumstances, to elect to be treated as having disposed of a share and as having reacquired it at the same amount. Its purpose is to permit the individual to report an accrued gain on a small business share in respect of which the taxpayer would be eligible to claim a capital gains exemption under section 110.6 of the Act. The deemed reacquisition of the share under section 48.1 prevents the share from qualifying as an eligible small business corporation share of the individual because the share is not deemed to have been acquired from the corporation that issued the share.

New subsection 44.1(11) provides that in determining if a share is an eligible small business corporation, the Act is to be read without reference to section 48.1.

Anti-Avoidance Rule

ITA
44.1(12)

New subsection 44.1(12) of the Act is an anti-avoidance rule. It applies where an individual or persons related to the individual dispose of shares of a particular corporation (which would normally result in the use of the corporate reorganisation rules or a return of paid-up capital of shares of the corporation) and acquire new shares of the particular corporation or a corporation that does not deal at arm's length with the particular corporation principally for the purpose of increasing the total amount of permitted deferrals with respect to qualifying dispositions of the individual and the related persons. Where the rule applies, the permitted deferral with respect to qualifying dispositions of the new shares is deemed to be nil.

For example, the rule will apply in cases where:

- a corporation reorganises its capital using section 86 of the Act in order to give its shareholders small business shares in exchange for its shares that did not qualify as small business shares in order to increase the amount of permitted deferrals in respect of qualifying dispositions of the shareholders;

- a corporate reorganisation is undertaken by a particular corporation principally in order to reduce the adjusted cost base of shares in order to increase the amount of permitted deferral of its shareholders with respect to qualifying dispositions of the shareholders;

- paid-up capital of shares of a particular corporation is returned to its shareholders followed by a subscription by the shareholders of shares issued by the particular corporation or a related corporation in order to increase the amount of permitted deferrals of the shareholders in respect of qualifying dispositions.

New section 44.1 applies to dispositions after February 27,2000 except that, for dispositions after February 27, 2000 and before October 18, 2000,

- the definition "active business corporation" in subsection 44.1(1) of the Act, is to be read without reference to the words "subject to subsection (10)" and as if the reference to the words "carried on" were read as reference to the words "carried on primarily in Canada",

- the definition "eligible small business corporation" in subsection 44.1(1) is to be read without reference to the words "subject to subsection (10)",

- the definition "eligible small business corporation share" in subsection 44.1(1), is to be read as;

  "eligible small business corporation share" of an individual means a common share issued by a corporation to the individual if

(a) at the time the share was issued, the corporation was an eligible small business corporation;

(b) immediately before the share was issued, the total carrying value of the assets of the corporation and corporations related to it did not exceed $2,500,000; and

(c) immediately after the share was issued, the total carrying value of the assets of the corporation and corporations related to it did not exceed $10,000,000,

- the definition "qualifying cost" in subsection 44.1(1), is to be read as if the reference to "$2,000,000" in subparagraph (*b*) thereof were read as a reference "$500,000",

- the definition "qualifying disposition" in subsection 44.1(1), is to be read without reference to the words "subject to subsection (9)",

- the definition "qualifying portion of a capital gain" in subsection 44.1(1), is to be read as if the reference to "$2,000,000" in paragraph (*c*) in the description of K in that definition were read as a reference to "$500,000" and section 44.1, is to be read without reference to subsections (9) and (10) thereof, and

- section 44.1 is to be read without reference to subsections (9) and (10)

Example 1

The following example demonstrates the determinations required under section 44.1 for dispositions after October 17, 2000.

Facts

An individual makes a qualifying disposition of shares of corporation A with an adjusted cost base of $3,000,000 for proceeds of disposition of $4,500,000.

The individual purchases replacement shares in corporations B with a cost of $2,200,000 and in corporation C with a cost of $2,300,000.

<u>*Determinations*</u>

The capital gain of the individual otherwise determined is $1,500,000 ($4,500,000 -$3,000,000).

The qualifying portion of the capital gain of the individual from the disposition is determined to be $1,000,000 by the formula J x (1-(K/L)) found in the definition of that expression in section 44.1(1) ($1,500,000 x (1- $1,000,000/$3,000,000) = $1,000,000) and represents the maximum amount of capital gain that can be deferred.

The qualifying portion of the proceeds of disposition of the individual from the disposition is determined to be $3,000,000 by the formula M x (N/O) found in the definition of that expression in section 44.1(1) ($4,500,000 x ($1,000,000/ $1,500,000) = $3,000,000) and represents the maximum amount of replacement share investments that can be used to determined the maximum permitted deferral in respect of the disposition.

The qualifying cost (subject to the $2,000,000 limit per related group of corporations) of the replacement shares in corporation B is $2,000,000 and in corporation C is $2,000,000 for a total of $4,000,000.

The permitted deferral of the individual in respects of the disposition is determined to be $1,000,000 by the formula (G/H) x I found in the definition of that expression in section 44.1(1). ($3,000,000/$3,000,000 x $1,000,000= $1,000,000.)

The capital gain from the disposition after deducting the permitted deferral in respect of the disposition is determined as $1,500,000 - $1,000,000 = $500,000.

The ACB reduction, which is determined by the formula D x (E/F) found in the definition of that expression in section 44.1(1), of the individual in respect of the replacement shares in corporation B is determined as $1,000,000 x (2,000,000/ $4,000,000) = $500,000 and in respect of the replacement shares in corporation C is determined as $1,000,000 x (2,000,000/ $4,000,000) = $500,000.

The adjusted cost base to the individual of the replacement shares in Corporation B is determined as ($2,2000,000 - $500,000) = $1,700,000 and of the replacement shares in corporation C ($2,300,000 - $500,000) = $1,800,000.

Example 2

The following example demonstrates the determinations required under section 44.1 for dispositions after February 27, 2000 and before October 18, 2000.

Facts

An individual makes a qualifying disposition of shares of corporation A with an adjusted cost base of $800,000 for proceeds of disposition of $1,600,000.

The individual purchases replacement shares in corporations B with a cost of $700,000 and in corporation C with a cost of $900,000.

Determinations

The capital gain of the individual otherwise determined is $800,000 ($1,600,000 -$800,000).

The qualifying portion of the capital gain of the individual from the disposition is determined to be $500,000 by the formula J x (1-(K/L)) found in the definition of that expression in section 44.1(1) ($800,000 x (1- $300,000/$800,000) = $500,000) and represents the maximum amount of capital gain that can be deferred.

The qualifying portion of the proceeds of disposition of the individual from the disposition is determined to be $1,000,000 by the formula M x (N/O) found in the definition of that expression in section 44.1(1) ($1,600,000 x ($500,000/ $800,000) = $1,000,000) and represents the maximum amount of replacement share investments that can be used to determined the maximum permitted deferral in respect of the disposition.

The qualifying cost (subject to the $500,000 limit per related group of corporations) of the replacement shares in corporation B is $500,000 and in corporation C is $500,000 for a total of $1,000,000.

The permitted deferral of the individual in respects of the disposition is determined to be $500,000 by the formula (G/H) x I found in the definition of that expression in section 44.1(1). ($1,000,000/$1,000,000 x $500,000= $500,000.)

The capital gain from the disposition after deducting the permitted deferral in respect of the disposition is determined as $800,000 - $500,000 = $300,000.

The ACB reduction, which is determined by the formula D x (E/F) found in the definition of that expression in section 44.1(1), of the individual in respect of the replacement shares in corporation B is determined as $500,000 x (500,000/ $1,000,000) = $250,000 and in respect of the replacement shares in corporation C is determined as $500,000 x (500,000/ $1,000,000) = $250,000.

The adjusted cost base to the individual of the replacement shares in Corporation B is determined as ($7000,000 - $250,000) = $450,000 and of the replacement shares in corporation C ($900,000 - $250,000) = $650,000.

Clause 18

Personal-Use property

ITA
46

Section 46 of the Act provides rules that apply to personal-use property (which is defined in section 54). The effect of these rules is to ensure that no gain or loss is recognized in respect of the first $1,000 of proceeds or cost of a personal-use property.

Subsection 46(2) provides related rules that apply where only part of a personal-use property is disposed of.

Subsections 46(1) and (2) are amended to exclude from their application "excluded property" that is disposed of in circumstances to which the charitable gift deduction in subsection 110.1(1) applies, or the definition "total charitable gifts", "total cultural gifts" or "total ecological gifts" in subsection 118.1(1) applies.

New subsection 46(5) defines excluded property of a taxpayer to mean, in general terms, property acquired by the taxpayer in circumstances in which it is reasonable to conclude that the acquisition relates to an arrangement, plan or scheme that is promoted by another person or partnership in circumstances where it is reasonable to conclude that the property will be the subject of a gift to which a charitable deduction or credit will be claimed under the Act.

These amendments apply to property acquired after February 27, 2000.

Clause 19

Identical Properties

ITA
47

Section 47 of the Act sets out rules that apply to identical properties for purposes of subdivision c of the Act, which deals with capital gains and capital losses on such properties.

Securities Acquired by Employee

ITA
47(3)

Subsection 47(1) of the Act requires that the cost of identical properties acquired by a taxpayer be averaged over all such properties. Generally, this results in each of the properties having the same adjusted cost base (ACB), thus ensuring that the capital gain or loss on the disposition of any one of the properties can be determined without having to identify a particular property as the property that has been disposed of.

New subsection 47(3) exempts certain securities acquired after February 27, 2000 from the cost-averaging rule by deeming such securities not to be identical to any other securities acquired by the taxpayer for the purposes of subsection 47(1). The specific securities to which subsection 47(3) applies are as follows:

- Securities (i.e., shares of a corporation and units of a mutual fund trust) acquired under an employee option agreement for which a deferral is provided under existing subsection 7(1.1) or new subsection 7(8) of the Act, and securities acquired in exchange for such securities under circumstances to which subsection 7(1.5) of the Act applied.

- Securities acquired under an employee option agreement where the securities are designated by the taxpayer and deemed by new subsection 7(1.31) of the Act to be the securities that are the subject of a disposition of identical securities occurring within 30 days after the acquisition.

- Employer shares received by an employee as part of a lump sum payment on withdrawing from a deferred profit sharing plan (DPSP), where the employee filed an election in respect of those shares under subsection 147(10.1) of the Act. Such an election allows the taxpayer to defer taxation on the growth of the shares while they were held by the plan until such time as the employee disposes of the shares.

The effect of a security being exempted from the cost-averaging rule in subsection 47(1) is that the ACB of the security, and thus the capital gain or loss on its disposition, is determined without regard to the ACB of any other securities owned by the taxpayer. In other words, each security to which subsection 47(3) applies has its own unique ACB.

It should be noted that, under amended subsection 7(1.3) and new subsection 7(1.31) of the Act, it is possible to determine when each security which is exempted from the cost averaging rule by subsection 47(3) is disposed of by the taxpayer. As noted above, subsection 7(1.31) deals with situations in which there is an acquisition of an employee option security and a disposition of an identical security within 30 days. Amended subsection 7(1.3) deals with securities for which a deferral is provided under subsection

7(1.1) or (8) or 147(10.1) of the Act (referred to in these notes as "deferral securities"). In general terms, subsection 7(1.3) deems a taxpayer to dispose of deferral securities only after having disposed of non-deferral securities, and then to dispose of deferral securities in the order in which they were acquired. Since it is possible to determine exactly when a particular security to which subsection 47(3) applies is disposed of, the fact that the security has its own unique ACB is not problematic.

It should also be noted that, where an employee acquires a security after February 27, 2000 under circumstances to which subsection 7(1.1) or (8) apply, the deferred employment benefit is added, pursuant to amended paragraph 53(1)(*j*) of the Act, to the ACB of the security at the time it is acquired even though the benefit is not subject to taxation until the security is disposed of.

The following examples illustrate the effect of subsection 47(3), in conjunction with the rules in subsections 7(1.3) and 7(1.31) for determining the order of disposition of identical securities and the amended ACB rule for employee option securities in paragraph 53(1)(*j*) of the Act.

Example 1

On March 1, 1998, Simon acquires 50 shares of his corporate employer on the open market for $5 each. The ACB of each share is $5. On March 1, 1999, Simon acquires another 50 shares on the open market for $15 each. By virtue of subsection 47(1), the ACB of each of the 100 shares is $10 (= ((50 x $5) + (50 x $15)) divided by 100).

On March 1, 2001, Simon exercises two different employee stock options and acquires two additional company shares. The fair market value (FMV) at that time is $100 per share. One of the options was granted on July 1, 1999 and has an exercise price of $25. The other option was granted on July 1, 2000 and has an exercise price of $30.

Simon elects under subsection 7(8) to defer recognition of the employment benefit of $75 (= $100 - $25) associated with the option granted in 1999 as well as the employment benefit of $70 (= $100 - $30) associated with the option granted in 2000.

Because of the election, subsection 47(3) excludes the shares from the cost-averaging rule in subsection 47(1). Thus, the ACB of the share acquired under the option granted in 1999 is $100 (= $25 cost amount + $75 deferred employment benefit added pursuant to amended paragraph 53(1)(j)). The ACB for the other stock option share is also $100 (= $30 cost amount + $70 deferred employment benefit added pursuant to paragraph 53(1)(j)).

Because of the application of subsection 47(3), the acquisition of the stock option shares does not affect the ACB of the previously-acquired 100 shares, which remains at $10 a share.

On March 1, 2002, Simon acquires an additional stock option share. The option was also granted on July 1, 2000 and has an exercise price of $30. The FMV of the share is $150. He elects, under subsection 7(8), to defer recognition of the employment benefit of $120 (= $150 - $30). Because of the election, the share is excluded from the cost-averaging rule. Thus, the ACB of the share is $150 (= $30 cost amount + $120 deferred employment benefit added pursuant to paragraph 53(1)(j)).

Because of the application of subsection 47(3), the ACB of the 100 market shares remains unchanged at $10 a share. Similarly, the ACB of each of the stock option shares acquired on March 1, 2001 remains unchanged at $100.

On December 1, 2003, Simon sells 60 shares for $160 a share. By virtue of subsection 7(1.3), Simon is deemed to have sold the 50 shares that he acquired on the open market on March 1, 1998, and 10 of the 50 shares that he acquired on the open market on March 1, 1999. The capital gain on each share is $150 (= $160 proceeds of disposition - $10 ACB), and the total capital gain is $9,000 (=$150 x 60).

In 2004, Simon sells another 40 shares for $180 a share. By virtue of subsection 7(1.3), he is deemed to have sold the remaining shares that he acquired on the open market. The capital gain on each share is $170 (= $180 proceeds of disposition - $10 ACB), and the total capital gain is $6,800 (= $170 x 40).

In 2005, Simon sells another share for $220. By virtue of subsection 7(1.3), he is deemed to have sold the stock option share that he acquired on March 1, 2001 under the option that was granted on July 1, 1999. In his tax return for 2005, he reports the employment benefit of $75 and the capital gain of $120 (= $220 - $100).

In 2006, he sells another share for $190. By virtue of subsection 7(1.3), he is deemed to have sold the stock option share that he acquired on March 1, 2001 under the option that was granted on July 1, 2000. In his tax return for 2006, he reports the employment benefit of $70 and the capital gain of $90 (= $190 - $100).

In 2007, Simon sells the one remaining share for $245. By virtue of subsection 7(1.3), he is deemed to have sold the stock option share that he acquired on March 1, 2002. In his tax return for that year, he reports the employment benefit of $120 and the capital gain of $95 (= $245 - $150).

If we were to assume that, in 2007, Simon acquired an additional share on the open market and later that year disposed of only one of the two shares in his possession, subsection 7(1.3) would deem the newly-acquired market share, rather than the one remaining stock option share, to be the share that is the subject of the disposition.

Example 2

Margaret owns 100 shares of her corporate employer. The shares have an ACB of $6 each. In July 2001, Margaret acquires another share under an employee stock option. The exercise price is $50 and the FMV is $150. As a result of the acquisition, she is deemed to have received a benefit from employment equal to $100, and is entitled to deduct 1/2 of the employment benefit under paragraph 110(1)(d). The share is publicly listed.

Margaret immediately donates an identical share to a qualifying charity. Under subsection 7(1.31), she identifies the newly-acquired share as the share being donated and, thus, is entitled to deduct another 1/4 of the employment benefit under paragraph 110(1)(d.01).

Because of the specific identification under subsection 7(1.31), the donated share is deemed not to be identical to the other shares for purposes of the cost-averaging rule in subsection 47(1). As a result, the ACB of the donated share is $150 (= $50 exercise price + $100 employment benefit). Under subsection 69(1), Margaret is deemed to have received proceeds of disposition for the donated share equal to its FMV at the time of donation, which is also $150. Therefore, there is no capital gain or loss determined in connection with the donated share. Furthermore, because of the application of subsection 47(3), the $6 ACB of the previously-acquired shares is unaffected by the acquisition of the donated share.

Clause 20

Adjustments to Cost Base

ITA
53

Section 53 of the Act sets out rules for determining the adjusted cost base of capital property for the purposes of calculating any capital gain or loss on its disposition. Certain adjustments to cost are made under this section. Subsection 53(1) provides for additions to cost and subsection 53(2) for deductions from cost.

ITA
53(1)(*e*) and (2)(*c*)

Paragraph 53(1)(*e*) provides additions to a taxpayer's cost of a partnership interest for the purpose of determining its adjusted cost base. Clause (i)(A) thereof provides an addition to the cost base for each fiscal period of the partnership equal to the amount that would be the taxpayer's share of the income of the partnership for that fiscal period if any amounts included in income in respect of eligible capital property, taxable capital gains and taxable net gains on listed personal property for that fiscal period were computed without reference to the fractions referred to in those provisions.

Paragraph 53(2)(*c*) provides deductions from the taxpayer's cost of a partnership interest for the purpose of determining its adjusted cost

base. Clause (i)(A) thereof provides for a deduction from the cost base for each fiscal period of the partnership equal to the amount that would be the taxpayer's share of any loss of the partnership for that fiscal period if any amounts deducted in respect of eligible capital property and allowable capital losses of the partnership were computed without the references to the fractions referred to in those provisions.

Clauses 53(1)(*e*)(i)(A) and 53(2)(*c*)(i)(A) are amended to add the references to the fraction in the formula in paragraph 14(1)(*b*) of the Act (as amended) and the variable C in that formula. These changes are consequential on the changes to the inclusion rates for the inclusion in income from business under subsection 14(1). Clause 53(1)(*e*)(i)(A) is also amended to correct an oversight in 1997 about the fraction in paragraph 38(*a*.1) concerning the taxable portion of a capital gain arising from certain donations.

These amendments apply in respect of fiscal periods that end after February 27, 2000.

ITA
53(1)(*j*)

Paragraph 53(1)(*j*) of the Act provides for an addition to the ACB of a security (i.e., a share of a corporation or a unit of a mutual fund trust) acquired by a taxpayer under an employee option agreement. The amount that is added to the ACB is the amount of the employment benefit that the taxpayer (or a non-arm's length person) is deemed by subsection 7(1) to have received in connection with the acquisition of the security. The amount is generally equal to the excess of the fair market value of the security at the time it is acquired over the amount paid to acquire the security under the option. The amount is added to the ACB in the year in which the benefit is deemed to have been received, which is generally the year in which the taxpayer acquires the security. However, in the case of an option granted by a Canadian-controlled private corporation (CCPC) to an arm's length person, subsection 7(1.1) applies to defer recognition of the benefit to the year in which the taxpayer disposes of the security.

Paragraph 53(1)(*j*) is amended to provide that, for all employee option securities acquired after February 27, 2000, the employment

benefit is included in the ACB of the security from the time of acquisition, even if recognition of the employment benefit is deferred, for tax purposes, until the taxpayer disposes of the security. This will be primarily relevant where securities for which a deferral is provided under either subsection 7(1.1), or new subsection 7(8) (which applies to publicly-listed shares and units of a fund trust), are exchanged for new securities in accordance with subsection 7(1.5), but in circumstances in which there is no rollover available, in respect of the disposition of the old securities, for capital gains purposes. The immediate inclusion in the ACB of the old securities ensures that the determination of the capital gain or loss on the disposition of those securities is not distorted by the exclusion of the deferred employment benefit associated with the acquisition of those securities.

ITA
53(1)(*r*)(A)(ii)

Paragraph 53(1)(*r*) of the Act increases an individual's adjusted cost base of each interest in, or share of the capital stock of, a flow-through entity described in any of paragraphs (*a*) to (*f*) of the definition "flow-through entity" by a pro-rata portion of the amount of the individual's unused exempt capital gains balance in respect of the entity where the individual disposes of all interests in and shares of the capital stock of the entity.

For the purpose of determining the unused portion of the individual's exempt capital gains balance in respect of the entity, the balance for the year is reduced by the total of all reductions in the year in capital gains because of the balance and 4/3 of the total of all reductions in the year of taxable capital gains or business income because of the balance.

Subparagraph (ii) of the description of A in paragraph 53(1)(*r*) is amended to replace the expression "4/3 of" with the word "twice". The amendment is consequential on the reduction of the inclusion rates for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in that subparagraph is to be read as reference to

the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies in respect of the entity for its taxation year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

ITA
53(2)(*a*)

Subparagraph 53(2)(*a*) of the Act provides for a reduction in the adjusted cost base of a share of an individual provided for under various provisions of the Act. The amendment to that subparagraph adds a reference to new paragraph 44.1(2)(*b*) of the Act which requires a reduction in the adjusted cost base of a replacement share of an individual as defined in new section 44.1.

This amendment applies to dispositions that occur after February 27, 2000.

ITA
53(2)(*c*)(i)(A)

See the commentary on the amendment to clause 53(1)(*e*)(i)(A).

ITA
53(2)(*c*)(ii)(B)

Paragraph 53(2)(*c*) of the Act provides for certain amounts that must be deducted in computing the adjusted cost base to a taxpayer of a partnership interest. Under subparagraph 53(2)(*c*)(ii), the deducted amounts at any time include the taxpayer's share of specified resource expenses (including foreign exploration and development expenses) for each fiscal period of the partnership that ends before that time. This treatment is provided because a taxpayer's share of each specified resource expense enters directly into the calculation of a taxpayer's resource deductions under sections 66 to 66.4. Under subsection 96(1), the specified resource expenses are ignored in computing partnership income.

Clause 53(2)(*c*)(ii)(B) is amended so that the specified resource expenses include foreign resource expenses, as defined in the definition "foreign resource expense" in new subsection 66.21(1). (The new expression "foreign resource pool expenses", as defined in

subsection 248(1), refers to both foreign resource expenses and foreign exploration and development expenses.)

This amendment applies to taxation years that begin after 2000.

ITA
53(2)(*h*)

Subparagraph 53(2)(*h*) of the Act reduces the adjusted cost base to a taxpayer of a capital interest in a trust in respect of amounts set out in subparagraphs 53(2)(*h*)(i) to (v). Subparagraph 53(2)(*h*)(i.1) refers to certain payments made by the trust after 1987 other than payments out of income of the trust or the non-taxable portion of the capital gains of the trust. The amendment to subclause 53(2)(*h*)(i.1)(B)(I) replaces the fraction "1/3" with the fraction "1/2" and is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, where the trust's taxation year that ends in the taxation year of the taxpayer includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" is to be read as reference to the fraction obtained when 1 is subtracted from the reciprocal of the fraction in amended paragraph 38(*a*) of the Act that applies to the trust for its taxation year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 21

Avoidance

ITA
55

Section 55 of the Act deals with certain tax avoidance transactions

Subsection 55(2) of the Act deals with intercorporate dividends that are ordinarily tax-free.

In order to prevent the conversion of capital gains on arm's length dispositions of property into tax-free intercorporate dividends,

subsection 55(2) treats, in certain circumstances, all or a portion of such a dividend to be either as proceeds of disposition of shares or as a capital gain and not as a dividend. Subsection 55(2) does not apply where the dividend can reasonably be considered to be attributed to what is known as "safe income" – income earned by a corporation after 1971 and before "safe-income determination time" (defined in subsection 55(1)), calculated according to the rules in paragraph 55(5)(*b*). Safe income is protected from the application of subsection 55(2) because this income has been subject to corporate income tax (or it represents the non-taxable portion of capital gains) and should therefore be permitted to be paid as a tax-free dividend to other Canadian corporations.

Applicable Rules

ITA
55(5)(*b*)

Paragraph 55(5)(*b*) of the Act provides rules for the calculation of income for the purposes of section 55. Subparagraph 55(5)(*b*)(iii) adds to income otherwise determined the "untaxed portion" of gains in respect of eligible capital property. Because, under existing paragraph 14(1)(*b*), a corporation's gain in respect of eligible capital property was previously aggregated with a recapture of the paragraph 20(1)(*b*) deductions that were previously claimed, subparagraph 55(5)(*b*)(iii) describes the untaxed portion of gains in respect of eligible capital property by reference to the corporation's cumulative eligible capital, eligible capital expenditures and variable E in the definition "cumulative eligible capital".

Amended paragraph 14(1)(*b*) of the Act identifies the taxable (2/3 for taxation years that end after February 27, 2000 and before October 18, 2000 and 1/2 for taxation years that end after October 17, 2000) portion of gains in respect of eligible capital property. Consequently it is possible to simplify the description of the untaxed (1/3) portion of gains in respect of eligible capital property for taxation years that end after February 27, 2000 and before October 18, 2000 and (1/2) portion for taxation years that end after October 17, 2000. Subparagraph 55(5)(*b*)(iii) is, therefore, amended to describe deemed income as calculated under that provision as it applied to taxation years that ended before February 28, 2000.

New subparagraph 55(5)(*b*)(iv) generally requires the inclusion in the calculation of income under paragraph 55(5)(*b*) of 1/2 of all amounts required by amended paragraph 14(1)(*b*) to be included in the corporation's income for taxation years that end after February 27, 2000 and before October 18, 2000.

New subparagraph 55(5)(*b*)(v) requires the inclusion of the amount required by paragraph 14(1)(*b*) to be included for taxation years that end after October 17, 2000.

Both these amounts are reduced to take into account the appropriate portion of bad debts in respect of dispositions of eligible capital property. The calculation of the reduction for bad debts is complicated by the interaction of different inclusion rates for capital gains that may be relevant during the period. New subparagraphs 55(5)(*b*)(iv) and (v) recognize both the deduction under subsection 20(4.2) of the Act and the deemed allowable capital loss under subsection 20(4.3) of the Act as amounts that reduce safe income. For further detail, see the commentary to subsections 20(4.2) and (4.3).

These amendments apply in respect of taxation years that end after February 27, 2000.

Clause 22

Scholarships, Bursaries, etc

ITA
56(1)(*n*) and (3)

Paragraph 56(1)(*n*) of the Act provides for the inclusion in a taxpayer's income for a year of certain scholarships, fellowships, bursaries and prizes for achievement, to the extent that the total of such amounts received in the year exceeds $500. The addition of subparagraph 56(1)(*n*)(ii) and subsection 56(3) provide for an additional $2,500 exemption for scholarships, fellowships and bursaries received by a taxpayer in connection with the taxpayer's enrolment in a program in respect of which the taxpayer may claim the education tax credit.

These amendments apply to the 2000 and subsequent taxation years.

Clause 23

Consideration for Foreign Resource Property

ITA
59(1) and (1.1)

Subsection 59(1) of the Act applies where a taxpayer has disposed of a foreign resource property. In computing the taxpayer's income for a taxation year, the proceeds of disposition that become receivable in the year are included in computing the taxpayer's income (net of outlays and expenses incurred for the purpose of making the disposition).

Subsection 59(1) is amended so that, to the extent that the taxpayer so designates, there is no income inclusion under subsection 59(1) in connection with the disposition of a foreign resource property of the taxpayer in respect of a country. Instead, the amount so designated reduces the taxpayer's "cumulative foreign resource expense" pursuant to paragraph (*a*) of the description of F in the definition "cumulative foreign resource expense" in new subsection 66.21(1). This amendment applies to taxation years that begin after 2000.

New subsection 59(1.1) provides a look-through rule so that members of a partnership can avail themselves of a designation under subsection 59(1). Subsection 59(1.1) is similar to the existing rules for partnership members in subsections 66.2(6) and 66.4(6). A related change to paragraph 96(1)(*d*) provides that a member's share of partnership income is computed without reference to subsection 59(1). New subsection 59(1.1) applies to fiscal periods of partnerships that begin after 2000.

ITA
59(3.2)(*c*.1)

Subsection 59(3.2) of the Act provides for the inclusion in a taxpayer's income of specified amounts.

For this purpose, new paragraph 59(3.2)(*c*.1) specifies amounts determined under new subsection 66.21(3), relating to "negative" FRE balances. For further detail, see the commentary on new subsection 66.21(3).

This amendment applies to taxation years that begin after 2000.

Clause 24

CPP/QPP Contributions on Self-Employed Earnings

ITA
60(*e*)

Section 60 of the Act provides for various deductions in computing income, including deductions in respect of certain payments to deferred income plans.

New paragraph 60(*e*) of the Act provides for the deduction of one-half of a taxpayer's contributions to the Canada or Quebec Pension Plan payable on the taxpayer's self-employed earnings, subject to one-half of the maximum of such contributions payable by the taxpayer under the plan. The appropriate percentage (generally the lowest marginal tax rate) of the other half of those contributions continues to be deductible under 118.7 (see the commentary on that section) in computing the taxpayer's tax payable.

This amendment applies to the 2001 and subsequent taxation years.

Clause 25

Child Care Expenses

ITA
63

Section 63 of the Act provides rules concerning the deductibility of child care expenses in computing a taxpayer's income.

ITA
63(1)(*a*)

Subsection 63(1) of the Act allows, subject to certain conditions, the deduction of child care expenses paid in a calendar year in respect of an eligible child, whether the expenses are paid by the taxpayer or by a supporting person of the child for the year. This amendment replaces an incorrect reference in paragraph 63(1)(*a*) to "subparagraph (2)(*b*)(vi)" with a reference to "paragraph 63(2)(*b*)" in order to reflect an amendment made in 1998.

This amendment applies to the 1998 and subsequent taxation years.

ITA
63(1)(*e*)(ii)

Paragraph 63(1)(*e*) of the Act provides for the computation of a taxpayer's deduction in respect of child care expenses. The annual maximum amount of child care expenses that may be claimed for a year in respect of an eligible child depends on the child's age and whether or not a disability tax credit may be claimed in respect of the child. Subparagraph 63(1)(*e*)(ii) is amended to refer to the annual child care expense amount that is relevant to a particular eligible child. The new expression "annual child care expense amount" is defined in subsection 63(3) (see the commentary on that subsection).

This amendment applies to the 2000 and subsequent taxation years.

ITA
63(2)(*b*) and (2.3)(*c*)

Subsections 63(2) to (2.3) of the Act provide for the calculation of the child care expense deduction where the claimant is the higher-income supporting person, or where the claimant is a student. In such circumstances, the claim is subject to a specific maximum which is computed by reference to the number of weeks (or months for part-time education) during which the lower-income supporting person is separated, infirm, confined to a bed or wheelchair, in prison or in attendance at school. This specific maximum referred to in the formulas used in paragraphs 63(2)(*b*) and (2.3)(*c*) is amended to refer

to the "periodic child care expense amount" in respect of a child. This new expression is defined in subsection 63(3) (see the commentary on that subsection).

These amendments apply to the 2000 and subsequent taxation years.

ITA
63(3)

Subsection 63(3) of the Act contains definitions for the purposes of the child care expense deduction.

"annual child care expense amount"

This new definition sets out the overall maximum amount that may be deducted for a year in respect of child care expenses for an eligible child. In the case of a child in respect of whom the disability tax credit may be claimed, the annual child care expense amount is increased to $10,000. For other eligible children, the deductible amount remains at $7,000 for children under 7 years of age at the end of the relevant year, and $4,000 for children aged 7 to 16 (or over if they are infirm).

"child care expense"

Paragraph (*c*) of this definition provides for a specific maximum for expenses paid for an eligible child's attendance at a boarding school or camp. The maximum amount is computed by reference to the number of weeks of attendance at the school or camp. This paragraph is amended to refer to the "periodic child care expense amount" in respect of the child. This new expression is defined in subsection 63(3) (see the commentary on that subsection).

"periodic child care expense amount"

This new definition sets out the maximum that may be claimed on a monthly or weekly basis, which is relevant when a claim is made by the higher-income supporting person. In all cases, the periodic child care expense amount in respect of an eligible child is equal to 1/40 of the annual child care expense amount in respect of that child.

These amendments apply to the 2000 and subsequent taxation years.

Clause 26

Attendant Care Expenses

ITA
64

Section 64 of the Act permits the deduction, in computing the income of an individual who has a severe and prolonged mental or physical impairment, of expenses paid to an attendant (other than the individual's spouse) who is at least 18 years of age that are incurred to enable the individual to work. Such an individual is allowed to deduct the lesser of the actual amount of expenses for attendant care provided in Canada and 2/3 of the individual's income from specific sources. This includes income from business, gross employment income, net research grants and the taxable portion of scholarships, fellowships, bursaries and similar awards.

Section 64 of the Act is amended to expand the list of eligible sources of income to include certain earnings supplements and financial assistance included in income under paragraph 56(1)(*r*). It is also amended to extend the deduction (up to a maximum of $10,000) to an individual who incurs attendant care expenses to attend a designated educational institution (see the commentary on subsection 118.6(1)) or high school.

These amendments apply to the 2000 and subsequent taxation years.

Clause 27

Exploration and Development Expenses

ITA
66

Section 66 of the Act provides rules in respect of Canadian and foreign exploration and development expenses.

Deduction for FEDE

ITA
66(4)

Subsection 66(4) sets out the deduction that may be claimed for foreign exploration and development expenses (FEDE).

ITA
66(4)(*a*)(i)

Subparagraph 66(4)(*a*)(i) of the Act provides that the amount deductible by a taxpayer under subsection 66(4) must relate to foreign exploration and development expenses (FEDE) incurred while the taxpayer was resident in Canada.

Subparagraph 66(4)(*a*)(i) is amended to cover the unusual situation where a taxpayer with FEDE had ceased to reside in Canada and then becomes resident in Canada again. In these circumstances,

- the FEDE incurred during the taxpayer's prior periods of residence is not taken into account once the taxpayer subsequently becomes resident in Canada (amended subparagraph 66(4)(*a*)(i)), and

- there is a deemed acquisition at fair market value of the taxpayer's foreign resource properties on becoming resident in Canada (subsection 128.1(1)).

This amendment applies to the 2000 and subsequent taxation years.

ITA
66(4)(*b*)

Paragraph 66(4)(*b*) of the Act generally limits a taxpayer's deduction under subsection 66(4) for a taxation year to the greater of 10% of the taxpayer's undeducted foreign exploration and development expenses (FEDE) at the end of the year and an amount, determined under subparagraph 66(4)(*b*)(ii), representing the taxpayer's foreign resource income for the year. However, subparagraph 66(4)(*b*)(i.1) provides for the deduction of the full FEDE balance in the event that the taxpayer is a corporation or trust that ceases to reside in Canada

immediately after the end of the year even if there is not sufficient supporting foreign resource income.

Paragraph 66(4)(*b*) is amended to eliminate the relief provided under subparagraph 66(4)(*b*)(i.1) for taxpayers who cease to reside in Canada. Instead, pursuant to new paragraph 115(1)(*e*.1), the unused FEDE balance can be applied to offset taxable income earned in Canada on a declining balance basis (10% per year). This amendment applies to cessations of residence that occur after February 27, 2000. As to the treatment of individuals who cease to reside in Canada, see the commentary to new subsection 66(4.3).

Subparagraph 66(4)(*b*)(ii) is amended so that deductions claimed under new subsection 66.21(4), which provides for the tax treatment of certain resource expenses that would be FEDE if they were incurred before 2001, do not result in any reduction of the foreign resource income determined under subparagraph 66(4)(*b*)(ii). This amendment is consequential on the introduction of section 66.21. This amendment applies to taxation years that begin after 2000.

Clause 66(4)(*b*)(ii)(C) is amended to clarify that deductions claimed by a taxpayer under subsection 66.7(2) (successor FEDE) will always result in a reduction of the taxpayer's foreign resource income determined under subparagraph 66(4)(*b*)(ii). Amended clause 66(4)(*b*)(ii)(C) also eliminates a reference to former section 64 that is no longer of any relevance. These amendments apply to taxation years that begin after 2000.

Reference should also be made to amendments being made to the definition of "foreign exploration and development expenses" in subsection 66(15). In general, FEDE balances will cease to be generated in taxation years that begin after 2000. Instead, new section 66.21 will apply with regard to expenses that are a "foreign resource expense" (FRE), as defined in subsection 66.21(1).

Country-by-Country FEDE Allocation

ITA
66(4.1) and (4.2)

Under existing subsection 66(4) of the Act, FEDE in respect of one country is not distinct from FEDE in respect of any other country.

New subsection 66(4.1) provides that, to the extent that a FEDE deduction under subsection 66(4) can reasonably be considered to be in respect of "specified foreign exploration and development expenses" (as newly defined in subsection 66(15)) in respect of a country, for greater certainty that portion of the FEDE deduction is deemed to apply to a source in that country. As a consequence, that portion of the FEDE deduction can result in a reduction of the limit for the taxpayer's foreign tax credit under section 126 in respect of the country and, pursuant to subparagraph 66.21(4)(*a*)(ii)(C), can also result in a reduction of the limit for the taxpayer's deduction of foreign resource expenses under new section 66.21.

New subsection 66(4.2) elaborates how an allocation to a country is made under subsection 66(4.1). The method of allocation must be reasonable in the circumstances and be consistently applied from year to year.

These amendments apply to taxation years that begin after 1999. However, in the event that a taxpayer elects to have the new foreign tax credit provisions in section 126 apply to taxation years that begin after a date (no earlier than December 31, 1994) designated by the taxpayer, these amendments apply on the same basis.

FEDE Deductions Where Change of Individual's Residence

ITA
66(4.3)

New subsection 66(4.3) of the Act applies where an individual becomes, or ceases to be, resident in Canada in a taxation year.

Under section 128.1 of the Act, the immigration or emigration of an individual (other than a trust) has no impact on an individual's taxation year. Consequently, the individual would be resident in Canada for part of the taxation year and not resident in Canada for another part, with the result that, absent subsection 66(4.3), the individual would not be permitted to deduct an amount for the year under subsection 66(4). (This is because subsection 66(4) provides that, for a taxpayer to claim a deduction under that subsection for a taxation year, the taxpayer must be resident in Canada throughout the year.) Furthermore, the wording of section 114 that applies to the 1998 and subsequent taxation years would, absent subsection 66(4.3),

preclude an individual who is resident in Canada for only part of a taxation year from obtaining a deduction in the year in respect of foreign exploration and development expenses (FEDE).

Consequently, subsection 66(4.3) provides that, for the purposes of subsection 66(4), a part-year resident's taxation year is treated as being the part of the taxation year throughout which the individual is resident in Canada and that, for these purposes, subsection 66(13.1) (which provides a rule relating to proration of deductions for short taxation years) does not apply to the individual for the year. As a result, an individual who is resident in Canada for only part of a taxation year can claim a non-prorated deduction under subsection 66(4). The deduction determined in this manner enters into the calculation of the individual's taxable income pursuant to section 114.

Given that section 128.1 operates to create new taxation years for trusts or corporations that become or cease to be resident in Canada, this measure has no relevance to trusts and there is no need to extend this measure to apply to corporations. Subsection 66(4.3) is parallel to new subsection 66.21(5), described in the commentary below.

This amendment applies to the 1998 and subsequent taxation years.

Dealers

ITA
66(5)

Subsection 66(5) of the Act provides that most of the special provisions with regard to the treatment of resource expenses do not apply in computing the income for a taxation year of a taxpayer (other than a principal-business corporation, as defined in subsection 66(15)) whose business includes trading or dealing in specified resource-related properties.

Subsection 66(5) of the Act is amended so that the subsection similarly limits the application of new section 66.21.

New subsection 66(5) applies to taxation years that begin after 2000.

Change of Control

ITA
66(11.4)

Subsection 66(11.4) of the Act applies where there is an acquisition of control of a corporation that was not a principal-business corporation immediately before the 12-month period preceding that acquisition of control. Any Canadian or foreign resource property acquired by the corporation (or a partnership of which it was a majority interest partner) in that period is (except for the purposes of applying the successor rules in section 66.7, notably the acquisition of control rule in subsection 66.7(10)) considered to have been acquired at the time control is acquired, for the purpose of subsection 66(4) (FEDE), section 66.2 (Canadian development expenses) and section 66.4 (Canadian oil and gas property expenses). Consequently, the corporation is prevented from claiming deductions under subsection 66(4) and sections 66.2 and 66.4 in respect of the property so acquired until after the acquisition of control. An exception to this treatment generally applies where the property in question was owned before that 12-month period described above by the corporation, the partnership or a person that was affiliated with the corporation.

Subsection 66(11.4) is amended so that it also applies for the purpose of section 66.21 (foreign resource expenses).

This amendment applies to taxation years that begin after 2000.

Limitations of FEDE and Foreign Resource Expenses

ITA
66(12.4), (12.41) and (12.42)

Subsection 66(12.4) of the Act provides special rules that apply where an amount (referred to below as a "specified amount receivable") becomes receivable by a taxpayer as a consequence of consideration, given by the taxpayer, the original cost of which was FEDE. The subsection does not apply where the consideration given is foreign resource property, given that an income inclusion resulting from the disposition of a foreign resource property is provided under subsection 59(1). Where subsection 66(12.4) applies, a taxpayer's FEDE balance is reduced by the specified amount receivable. If the

specified amount receivable exceeds the FEDE balance, the excess is included in income.

Subsection 66(12.4) is amended so that it also applies in connection with consideration the original cost of which is excluded from FEDE because of new paragraph (*k*) of the FEDE definition in subsection 66(15). That paragraph excludes amounts from FEDE that form part of a taxpayer's foreign resource expenses (as defined in the definition "foreign resource expense" in new section 66.21).

Subsection 66(12.4) is also amended so that a designated portion of a specified amount receivable is, to the extent that it is primarily in respect of specified FEDE in respect of a country (as newly defined in subsection 66(15)) or a foreign resource expense in respect of a country (as newly defined in subsection 66.21(1)), not taken into account under subsection 66(12.4). Instead, the amount so designated will be taken into account under new subsection 66(12.41). The intended effect of this amendment is to permit a taxpayer to elect out of the tax consequences under subsection 66(12.4).

Subsection 66(12.41) is introduced so that the designated portion of a specified amount receivable by a taxpayer in respect of a country results in a reduction of the "cumulative foreign resource expense" of the taxpayer in respect of that country.

Subsection 66(12.42) is introduced so that, where a partnership has a specified amount receivable, each partner of the partnership is considered for the purposes of subsections 66(12.4) and (12.41) to have had the partner's share of that amount become receivable. New subsection 66(12.42) is consistent with the fact that a partner's share of FEDE and foreign resource expenses qualifies as such.[1] In addition, subsection 66(12.42) is consistent with the existing treatment of amounts receivable by partnerships in connection with the calculation of "cumulative Canadian exploration expense"[2],

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[1] Existing paragraph (*d*) of the definition "foreign exploration and development expenses" in subsection 66(15) and paragraph (e) of the definition "foreign resource expenses" in new subsection 66.21(1).
[2] See reference to the description of G in that definition in subsection 66.1(7).

"cumulative Canadian development expense"[3] and "cumulative Canadian oil and gas property expense".[4]

Amended subsection 66(12.4) and new subsection 66(12.41) apply to taxation years that begin after 2000. New subsection 66(12.42) applies to fiscal periods that begin after 2000.

Short Taxation Year

ITA
66(13.1)

Subsection 66(13.1) of the Act limits the amount of FEDE, Canadian development expenses and Canadian oil and gas property expenses that a taxpayer may deduct in computing income where the amount is based on a percentage of the unclaimed balance. For a taxation year that is less than 51 weeks, the amount that may be deducted cannot exceed that portion of the amount otherwise determined that the number of days in the taxation year is of 365.

Subsection 66(13.1) is amended to similarly apply in determining the amount of foreign resources expenses deductible under new subsection 66.21(4) and successor foreign resource expenses deductible under new subsection 66.7(2.3).

This amendment applies to taxation years that begin after 2000.

Definitions

ITA
66(15)

Subsection 66(15) of the Act contains various definitions for the purposes of section 66.

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[3] See reference to the description of G in that definition in subsection 66.2(6).
[4] See reference to the description of G in that definition in subsection 66.4(6).

ITA
66(15)

"Canadian resource property"

The definition "Canadian resource property" is set out in subsection 66(15).

Paragraph (*c*) of that definition covers "any oil or gas well in Canada or any real property in Canada the principal value of which depends on its petroleum or natural gas content (but not including any depreciable property used or to be used in connection with the extraction or removal of petroleum or natural gas therefrom)". This paragraph is amended to delete the words "used or to be used in connection with the extraction or removal of petroleum or natural gas therefrom" following the words "depreciable property". This amendment parallels new paragraph (*c*) of the amended definition "foreign resource property" in subsection 248(1), as described in the commentary below. This amendment applies to taxation years that begin after 2000.

Paragraph (*f*) of that definition covers "any real property in Canada the principal value of which depends on its mineral resource content (but not including any depreciable property used or to be used in connection with the extraction or removal of minerals therefrom)". This paragraph is amended to delete the words "used or to be used in connection with the extraction or removal of minerals therefrom " following the words "depreciable property". This amendment parallels new paragraph (*f*) of the amended definition "foreign resource property" in subsection 248(1), as described in the commentary below. This amendment applies to taxation years that begin after 2000.

"foreign exploration and development expenses"

The definition "foreign exploration and development expenses" (FEDE) is set out in subsection 66(15) of the Act. FEDE balances are deductible to the extent provided under subsection 66(4). Paragraph (*b*) of the definition includes in FEDE any prospecting, exploration or development expenses incurred by a taxpayer in searching for minerals outside Canada. A number of explicit

exclusions from FEDE are provided under paragraphs (*f*) to (*i*) of the definition.

Paragraph (*b*) of the definition is amended so that prospecting, exploration and development expenses covered by that paragraph must be incurred for the purpose of determining the existence, location, extent or quality of a "mineral resource" (as defined in subsection 248(1)) outside Canada. This amendment makes paragraph (*b*) of the FEDE definition more consistent with paragraph (*f*) of the definition "Canadian exploration expense" in subsection 66.1(6). This amendment applies to expenses incurred after Announcement Date, other than expenses incurred pursuant to an agreement in writing made before Announcement Date + 1].

Paragraph (*j*) of the definition is introduced to ensure that an expenditure that is the cost, or any part of the cost, to the taxpayer of depreciable property of a prescribed class is excluded from FEDE. This measure, which complements existing paragraph (*f*) of the definition, is provided for greater certainty and is consistent with similar language in the exclusions within the definitions "Canadian exploration expense" in subsection 66.1(6) and "Canadian development expense" in subsection 66.2(5). This amendment applies to property acquired after Announcement Date.

New paragraph (*k*) of the definition excludes foreign resource expense (as defined in the definition "foreign resource expense" in subsection 66.21(1)) from FEDE. Foreign resource expense (FRE) covers the same expenditures as FEDE (as amended), except that FRE expenditures are incurred in taxation years that begin after 2000 and FRE expenditures are explicitly linked to a particular country. This amendment applies to taxation years that begin after 2000.

New paragraph (*l*) of the definition excludes expenditures made by a taxpayer after February 27, 2000 unless:

- the expenditure was made pursuant to an agreement in writing made by the taxpayer before February 28, 2000,

- the expenditure was for the acquisition of foreign resource property by the taxpayer, or

- the expenditure was incurred for the purpose of

    - enhancing the value of foreign resource property that the taxpayer owned at the time the expenditure was incurred or that the taxpayer had a reasonable expectation of owning after that time, or

    - assisting in evaluating whether a foreign resource property is to be acquired by the taxpayer.

"original owner"

An "original owner" of a resource property for the purposes of the successor rules in section 66.7 of the Act is defined as a person

- who owned the resource property and disposed of it to a corporation in circumstances where the successor rules apply to the corporation in respect of the property, and

- who would, but for that disposition and the resulting reduction of resource pools available to the person, be entitled in computing income for a taxation year that ends after the disposition to a deduction in respect of the resource expenses incurred by the person prior to the disposition.

This definition is amended to add cross-references to the new rules governing the treatment of foreign resource expenses under subsections 66.21(4) and 66.7(2.3) and (13.1). Similarly, the existing reference to "foreign exploration and development expenses" (as defined in subsection 66(15)) is replaced by a more general reference to "foreign resource pool expenses" (as defined in subsection 248(1)).

This amendment applies to taxation years that begin after 2000.

"predecessor owner"

A "predecessor owner" of a resource property for the purposes of the successor rules in section 66.7 of the Act is defined as a corporation

- that acquired the resource property in circumstances where the successor rules apply to it in respect of the property,

- that disposed of the property to another corporation in circumstances where the successor rules apply to the other corporation in respect of the property, and

- that would, but for the disposition and resulting reduction of successor pools available to the corporation, be entitled in computing its income from the property for a taxation year ending after the disposition to a deduction in respect of the resource expenses incurred by an original owner of the property.

This definition is amended to add cross-references to the new rules governing the treatment of foreign resource expenses under new subsections 66.7(2.3) and (15.1).

This amendment applies to taxation years that begin after 2000.

"specified foreign exploration and development expense"

The new definition "specified foreign exploration and development expense" in subsection 66(15) of the Act provides for a subcategory of FEDE. The definition explicitly links FEDE (determined with reference to the amendments to the definition "foreign exploration and development expenses", described above) to the particular country in which the foreign resource property that relates to a given expenditure is situated. The definition is used in new subsections 66(4.1) and (4.2), amended subsection 66(12.4) and new subsections 66(12.41) and 66.7(2.1) and (2.2). For more detail, see the commentary on subsections 66(4.1) and (4.2).

This definition applies after 1994, given that those subsections can apply from as early as January 1, 1995.

Other Definitions

ITA
66(15.1)

Subsection 66(15.1) of the Act provides that the definitions in sections 66.1, 66.2, 66.4 and 66.5 of the Act apply for the purposes of section 66.

Subsection 66(15) of the Act is amended so that this measure also applies with regard to the definitions in new section 66.21.

This amendment applies after 2000.

Members of Partnerships

ITA
66(18)

Existing subsection 66(18) of the Act clarifies the tax treatment of a person (including a partnership) who is a member of a partnership involved in mining or oil and gas. Where a resource expenditure is attributed by the partnership to the member, the member is treated under this provision as having incurred the attributed expenditure at the end of the fiscal period in which that expenditure is incurred by the partnership to the extent that such attributed expenditure is included in the member's foreign exploration and development expense (FEDE), Canadian exploration expense (CEE), Canadian development expense (CDE) or Canadian oil and gas property expense (COGPE).

Subsection 66(18) is amended to provide the same tax treatment with regard to expenses that are a foreign resource expense, as defined in new subsection 66.21(1).

This amendment applies to fiscal periods that begin after 2000.

Clause 28

Canadian Exploration Expense

ITA
66.1

Section 66.1 of the Act provides the rules relating to the deduction of "Canadian exploration expense" (CEE) (as defined in subsection 66.1(6)). Specifically, the deduction of CEE is provided for through the concept of "cumulative Canadian exploration expense" (as defined in subsection 66.1(6)) and deductions under subsections

66.1(2) and (3) with respect to cumulative Canadian exploration expense.

Definitions

ITA
66.1(6)

Subsection 66.1(6) of the Act provides several definitions for the purpose of section 66.1.

"cumulative Canadian exploration expense"

The description of L, in the formula in the definition "cumulative Canadian exploration expense", provides that the investment tax credit claimed by a taxpayer under subsection 127(5) or (6) of the Act, in a year preceding the taxpayer's taxation year, in respect of a qualified Canadian exploration expenditure reduces the taxpayer's cumulative Canadian exploration expense (CCEE) pool in the taxation year. (The expression "qualified Canadian exploration expense" was previously defined in subsection 127(9). The definition of that expression was repealed by S.C. 1996, c. 21, subsection 30(9), applicable to taxation years that begin after 1995.)

The description of L is amended, after October 17, 2000, to provide that a taxpayer's CCEE is reduced by any investment tax credit claimed by the taxpayer in respect of a flow-through mining expenditure of the taxpayer. (See the commentary on the new definition "flow-through mining expenditure" in subsection 127(9) for further details.) Because the investment tax credit calculation can become circular if the credit were to reduce CCEE in the same year in which the credit is claimed, the description of L requires a reduction of the CCEE in the taxation year following the year in which the credit is claimed.

The amendment to the definition of CCEE applies after October 17, 2000.

Clause 29

Foreign Resource Expense

ITA
66.21

New section 66.21 of the Act sets out the rules governing foreign resource expenses (FRE). The expression "foreign resource expense" in subsection 66.21(1) is defined essentially in the same way as FEDE, except that there are separate FRE accounts in respect of each country to which FRE relates. FRE applies to expenses incurred in taxation years that begin after 2000, although a partner's FRE is determined with reference to partnership fiscal periods that begin after 2000. FRE is explicitly excluded from the amended FEDE definition in subsection 66(15). Section 66.21 is structured as follows:

- subsections 66.21(1) and (2) provide definitions used in section 66.21;

- subsection 66.21(3), in conjunction with paragraph 59(3.2)(*c*.1), provides for an amount to be included in income where there is a "negative" FRE balance;

- subsection 66.21(4) provides for a deduction in respect of the FRE balance for a taxation year. Generally, the deduction cannot exceed 30% of the balance at the end of the year; and

- subsection 66.21(5) provides a special rule for individuals who cease to reside in Canada.

New section 66.21 applies to taxation years that begin after 2000. The structure of section 66.21 and related successor rules in section 66.7 is similar to parallel rules for Canadian development expenses.

Definitions

ITA
66.21(1)

New subsection 66.21(1) of the Act sets out a number of definitions.

"adjusted cumulative foreign resource expense"

The "adjusted cumulative foreign resource expense" of a taxpayer in respect of a country at the end of a taxation year is the taxpayer's cumulative foreign resource expense at the end of the year, plus an adjustment that applies in the event that the taxpayer disposes of foreign resource properties in the year in circumstances to which the successor rules in section 66.7 of the Act apply. The purpose of this adjustment is to permit a taxpayer to claim deductions for a taxation year of a succession in respect of foreign resource expenses incurred before the succession occurs, despite the taxpayer's cumulative FRE being reduced to nil under the description of J of the definition "cumulative foreign resource expense" as a consequence of a succession.

This definition is used in subsection 66.21(4). Its effect is illustrated in the example contained in the commentary on new subsections 66.7(13.1) and (13.2).

"cumulative foreign resource expense"

The definition "cumulative foreign resource expense" is essentially the balance of unused FRE, determined as of a particular time. The FRE deduction under subsection 66.21(4) for a taxation year is determined with reference to cumulative FRE at the end of the year. In general, cumulative FRE at any time for a taxpayer in respect of a country is determined as follows:

- [A] ADD the taxpayer's FRE incurred in respect of the country before that time;

- [B] ADD "negative" FRE balances in respect of the country previously included in computing the taxpayer's income;

- [C] ADD bad debt amounts in respect of amounts receivable previously deducted in computing cumulative FRE under the descriptions of F or G (described below);

- [D] ADD specified amounts under subsection 66.7(13.2), representing cumulative FRE in respect of the country not available to a successor after there has been a disposition of foreign resource properties by the taxpayer in circumstance to

which the successor rules in section 66.7 applies (See, in this regard, the example in the commentary on subsections 66.7(13.1) and (13.2).);

- [E] SUBTRACT the taxpayer's previous FRE claims in respect of the country;

- [F] SUBTRACT previous proceeds from the disposition of foreign resource properties in respect of the country, to the extent allocated under new subparagraph 59(1)(*b*)(ii). However, in cases where those properties were acquired by the taxpayer in circumstances to which the successor rules apply, proceeds are applied first to reduce unused successor FRE balances under new subsection 66.7(2.3);

- [G] SUBTRACT amounts receivable that enter into the calculation of cumulative FRE in respect of the country because of new subsection 66(12.41);

- [H] SUBTRACT recoveries of bad debts previously reflected as an addition under the description of C;

- [I] SUBTRACT adjustment provided because of the debt forgiveness rules in section 80; and

- [J] where the taxpayer previously disposed of foreign resource properties in circumstances to which the successor rules applied, SUBTRACT the taxpayer's cumulative FRE in respect of the country as of the time of the succession.

In calculating cumulative FRE at any time, the amounts that would otherwise be included in [A] to [J] and that relate to periods of time during which the taxpayer was not resident in Canada are ignored. If a taxpayer had previously been a resident of Canada, ceased to reside in Canada and subsequently becomes a resident in Canada, amounts that would otherwise be included in [A] to [J] and that relate to the previous periods of residence in Canada are likewise ignored.

"foreign resource expense"

See the first paragraph of the commentary on this section.

"foreign resource income"

The new definition "foreign resource income" is structured in a manner similar to that of the foreign resource income limitation provided under amended subparagraph 66(4)(*b*)(ii), except that the new definition applies on a country-by-country basis while subparagraph 66(4)(*b*)(ii) applies to world-wide income. In general terms, the definition refers to a taxpayer's mineral, oil and gas production and royalty income in respect of a country, as well as income from the disposition of foreign resource property in respect of the country. In computing foreign resource income, deductions under subsections 66(4) and 66.21(4) are not taken into account. (However, successor deductions under subsections 66.7(2) and (2.3) are taken into account and can result in a decrease of foreign resource income.)

"foreign resource loss"

The "foreign resource loss" of a taxpayer for a taxation year in respect of a country (other than Canada) is defined as the taxpayer's loss for a taxation year in respect of the country determined in accordance with the definition "foreign resource income", with such modifications as the circumstances require.

The expression "foreign resource loss" is used in new clause 66.21(4)(*a*)(ii)(D).

"global foreign resource limit"

A taxpayer's deduction limit for FRE under new subsection 66.21(4) is determined with reference to the taxpayer's "global foreign resource limit". Without reference to the "global foreign resource limit", a taxpayer cannot deduct in respect of a country more than 30% of the taxpayer's cumulative FRE in respect of the country. In general terms, the definition "global foreign resource limit" and paragraph 66.21(4)(*b*) are structured to permit a taxpayer to deduct a higher amount of the taxpayer's cumulative FRE in respect of a country, provided that on an overall basis the taxpayer claims no more than the lesser of:

- 30% of the taxpayer's total cumulative FRE in respect of all countries; and

- the taxpayer's global foreign resource income determined under subparagraph 66(4)(*b*)(ii), other than the portion of it used to support the taxpayer's deduction under subsection 66(4) or to support total deductions otherwise available under subsection 66.21(4).

Incorporation of Definitions

ITA
66.21(2)

Subsection 66.21(2) of the Act provides that the definitions in subsection 66(15) apply for the purposes of section 66.21. The relevant definitions include the expressions "foreign resource property", "production" and "drilling or exploration expense".

Amount to be Included in Income

ITA
66.21(3)

Subsection 66.21(3) of the Act provides for an amount to be included in computing a taxpayer's income for a taxation year where there is a "negative" FRE balance. In the event that the taxpayer disposes of foreign resource properties in the year in circumstances in which the successor rules apply, the income inclusion is offset by the taxpayer's FRE balance immediately before the succession (other than the portion of the balance that the taxpayer has made exclusively available to the successor because of a designation under subparagraph 66.7(13.2)(*a*)(ii)).

Deduction for Cumulative Foreign Resource Expense

ITA
66.21(4)

Subsection 66.21(4) of the Act permits a deduction in respect of a taxpayer's cumulative FRE in respect of each country. The deduction for a taxation year is generally available only to persons resident in Canada throughout the year. See, however, subsection 66.21(5) (application of subsection 66.21(4) to part-year residents) and new paragraph 115(1)(*e*.1) (FRE deduction for non-residents).

The limit of the permitted deduction is determined in accordance with subsection 66.21(4). The limit is not less than 10% of the taxpayer's cumulative FRE in respect of the country at the end of a taxation year and, in all cases, is not more than the full amount of the balance. Cumulative FRE for this purpose is adjusted, as explained in the commentary on the definition "adjusted cumulative foreign resource expense".

Subject to paragraph 66.21(4)(*b*) and the 10% minimum limit, the maximum that a taxpayer may deduct in computing income for a taxation year in respect of a country is generally an amount that does not exceed the least of

- the amount of the taxpayer's "foreign resource income" in respect of the country,
- 30% of the taxpayer's adjusted cumulative FRE at the end of the year,
- the amount determined by clause 66.21(4)(*a*)(ii)(C), and
- the amount determined by clause 66.21(4)(*a*)(ii)(D).

In connection with clause 66.21(4)(*a*)(ii)(C), see the commentary on new subsections 66(4.1) and (4.2).

With regard to the defined expression "foreign resource income", see the commentary on the expression "foreign resource income" in subsection 66.21(1).

Paragraph 66.21(4)(*b*) permits, in some cases, a taxpayer to deduct a higher amount from the taxpayer's cumulative FRE in respect of a country than would otherwise be the case. The additional deduction is equal to the lesser of:

- the amount by which the taxpayer's cumulative FRE in respect of the country at the end of the year exceeds the portion of it that would otherwise be deductible under subsection 66.21(4) in computing the taxpayer's income for the year; and
- the portion of the taxpayer's "global foreign resource limit" designated by the taxpayer in respect of the country.

The effect of paragraph 66.21(4)(*b*) is to permit a taxpayer to deduct an additional amount of the taxpayer's cumulative FRE in respect of a country beyond the 10% or 30% limit set out in paragraph 66.21(4)(*a*). The additional amount is determined with reference to a taxpayer's "global foreign resource limit" (as described in the commentary above), which is intended to allow additional deductions in order to permit a taxpayer to use, in aggregate, up to 30% of the taxpayer's total cumulative FRE in respect of all countries to the extent that there is sufficient supporting global foreign resource income.

As provided in subsection 66.21(4), FEDE claims by a taxpayer may affect the amount of permitted deduction in respect of cumulative FRE.

Individual Changing Residence

ITA
66.21(5)

Subsection 66.21(5) of the Act applies where an individual becomes, or ceases to be, resident in Canada in a taxation year.

Under section 128.1, the immigration or emigration of an individual (other than a trust) has no impact on an individual's taxation year. Consequently, the individual would be resident in Canada for part of the taxation year and not resident in Canada for another part, with the result that, absent subsection 66.21(5), the individual would otherwise not be permitted to deduct an amount for the year under subsection 66.21(4). (This is because subsection 66.21(4) provides that, for a taxpayer to claim a deduction under that subsection for a taxation year, the taxpayer must be resident in Canada throughout the year.) Furthermore, the wording of section 114 that applies to the 1998 and subsequent taxation years would, absent subsection 66.21(5), preclude an individual who is resident in Canada for only part of a taxation year from obtaining a deduction in the year in respect of cumulative FRE.

Consequently, subsection 66.21(5) provides that, for the purposes of subsection 66.21(4), a part-year resident's taxation year is treated as being the part of the taxation year throughout which the individual is resident in Canada and that, for these purposes, subsection 66(13.1)

(which provides a rule relating to proration of deductions for short taxation years) does not apply to the individual for the year. As a result, an individual who is resident in Canada for only part of a taxation year can claim a non-prorated deduction under subsection 66.21(4). The deduction determined in this manner enters into the calculation of the individual's taxable income pursuant to section 114.

Given that section 128.1 operates to create new taxation years for trusts or corporations that become or cease to be resident in Canada, this measure has no relevance to trusts and there is no need to extend this measure to apply to corporations. Subsection 66.21(5) is parallel to new subsection 66(4.3), described in the commentary above.

Subsection 66.21(5) provides that, in this case, the individual's taxation year for the purposes of subsection 66.21(4) is considered to be the period or periods throughout which the individual is resident in Canada. The deduction determined in this manner enters into the calculation of the individual's taxable income pursuant to section 114.

Clause 30

Successor Rules

ITA
66.7

Section 66.7 of the Act provides rules (commonly known as the "successor rules") relating to the deduction, by a "successor corporation", of unused resource expenses of another person in respect of resource properties acquired by the successor corporation.

Country-by-Country Successor FEDE Allocations

ITA
66.7(2.1) and (2.2)

Under existing subsection 66.7(2) of the Act, successor FEDE in respect of one country is not distinct from successor FEDE in respect of another country.

New subsection 66.7(2.1) provides that, to the extent that a successor FEDE deduction under subsection 66.7(2) can reasonably be considered to be in respect of "specified foreign exploration and development expenses" (as newly defined in subsection 66(15)) in respect of a country, for greater certainty that portion of the successor FEDE deduction is considered to apply to a source in that country. As a consequence, that portion of the successor FEDE deduction can result in a reduction of the limit for the taxpayer's foreign tax credit under section 126 in respect of the country and, pursuant to clause 66.21(4)(*a*)(ii)(C) or (D), can also result in a reduction of the limit for the taxpayer's deduction of foreign resource expenses under new section 66.21.

New subsection 66.7(2.2) elaborates on how an allocation to a country is made under subsection 66.7(2.1). The method of allocation must be reasonable in the circumstances and be consistently applied from year to year.

New subsections 66.7(2.1) and (2.2) are analogous to new subsections 66(4.1) and (4.2), described in the commentary above.

These amendments apply to taxation years that begin after 1999. However, in the event that a taxpayer elects to have the new foreign tax credit provisions under section 126 apply to taxation years that begin after an earlier date (not earlier than December 31, 1994) designated by the taxpayer, these amendments apply on the same basis.

Successor of Foreign Resource Expenses

ITA
66.7(2.3)

New subsection 66.7(2.3) of the Act provides for the transfer of an original owner's unused foreign resource expense (FRE) balance, on an acquisition of foreign resource properties from the original owner in circumstances to which the successor rules apply. Subsection 66.7(2.3) is structured much like the deduction for successor Canadian development expense in subsection 66.7(4), in that proceeds from the disposition of such foreign resource properties are generally applied to reduce the successor FRE balance. The amount by which a successor FRE balance is reduced offsets the amount of reduction

otherwise required under subsection 66.21(1) to the successor's own cumulative FRE.

The unused amount of a successor FRE balance may be deducted against "streamed income" (as determined under subparagraph 66.7(2.3)(*b*)(i)) in respect of the foreign resource properties acquired on the succession. This subparagraph refers only to income from production, not to proceeds of disposition, given the treatment of proceeds described immediately above. Under subparagraph 66.7(2.3)(*b*)(ii), any "streamed income" from Canadian resource properties acquired with such foreign resource properties on a succession can be used to support additional successor FRE deductions required in order for the successor to claim up to 10% of the successor FRE balance in a taxation year. Subparagraph 66.7(2.3)(*b*)(ii) is consistent with subparagraph 66.7(2)(*b*)(ii), and ensures that the 10% minimum relating to maximum deductions with regard to FEDE or FRE is not lost on a succession involving a mixture of Canadian and foreign resource properties if there is sufficient overall foreign and Canadian resource income to support the 10% minimum. However, any "streamed income" can only be used once in determining the level of deductions to which a taxpayer is entitled under subsection 66.7(2) or (2.3). In addition, deductions under those subsections can limit the extent to which a taxpayer can claim deductions under subsections 66(4) and 66.21(4).

The operation of subsection 66.7(2.3) and related provisions are illustrated in the example below.

Example

ABC Corp. has an outstanding successor FEDE pool of $30,000, an outstanding successor FRE pool of $20,000, a FEDE balance in its own right of $70,000 and cumulative FRE of $40,000. In 2001, ABC disposes of all its foreign resource properties acquired on the succession for $145,000. ABC designates $60,000 under subparagraph 59(1)(b)(ii), so that the amount included in its income under subsection 59(1) is $85,000. There are no relevant transactions or events after the succession, and no relevant production income in 2001. ABC uses calendar years as its taxation years.

Results:

1. ABC is permitted to deduct the full amount ($30,000) of its successor pool under subsection 66.7(2) for its 2001 taxation year. For this purpose, ABC's streamed income is equal to the $85,000 included under subsection 59(1) in computing ABC's income.

2. No deduction is permitted under subsection 66.7(2.3), because the $60,000 designated amount reduces the successor FRE pool under subparagraph 66.7(2.3)(a)(ii). Instead, under paragraph (b) of the description of F in the definition "cumulative foreign resource expense" in subsection 66.21(1), the resulting $20,000 grind to the successor FRE pool offsets the amount by which ABC's own cumulative FRE is required to be reduced.

3. ABC will therefore not be entitled to deduct any amount under subsection 66.21(4) for its 2001 taxation year because its cumulative FRE is nil (i.e., ($40,000 – ($60,000 - $20,000)) at the end of the year. For the same reason, ABC's income inclusion under subsection 66.21(3) for the year is nil.

4. The amount deductible by ABC under subsection 66(4) for the year is equal to $55,000, which is the lesser of:

- *70,000 (subparagraph 66(4)(b)(i)), and*
- *$85,000 (subsection 59(1) and subclause 66(4)(b)(ii)(C)(I)), minus $30,000 (subclause 66(4)(b)(ii)(C)(II)).*

5. As a consequence, $15,000 of FEDE remains available for deduction in a subsequent year or years.

6. The following table summarizes these results

A. Pool	***B. Pool Amount***	***C. Portion of "B" used***
successor FEDE	*$30,000*	*$30,000*
successor FRE	*$20,000*	*$20,000*
FEDE balance	*$70,000*	*$55,000*
cumulative FRE	*$40,000*	*$40,000*
TOTAL	*$160,000*	*$145,000*

New subsection 66.7(2.3) applies to taxation years that begin after 2000.

Application of subsections (2) and (3) – Restrictions with Regard to the Applicability of the Successor Rules

ITA
66.7(8)

Subsection 66.7(8) of the Act generally provides a restriction under which the successor rules for FEDE in subsection 66.7(2) apply only with regard to acquisitions by a corporation of all or substantially all of the foreign resource properties of another person.

Subsection 66.7(8) is amended to include a reference to new subsection 66.7(2.3), so that the same restriction applies with regard to the successor rules for FRE in new subsection 66.7(2.3).

This amendment applies to taxation years that begin after 2000.

Change of Control

ITA
66.7(10)

Under subsection 66.7(10) of the Act, a corporation is treated as a successor for the purposes of the successor rules in section 66.7 after an acquisition of control (or a change in the tax-exempt status) of the corporation.

This subsection is amended to replace a reference to foreign exploration and development expenses with a more general reference to foreign resource pool expenses, as defined in subsection 248(1).

This amendment applies to taxation years that begin after 2000.

Change of Control (Special Rules relating to Parent-Subsidiary Income Allocations)

ITA
66.7(10)(*h*)

Where control of a parent corporation is acquired at a time when it owns foreign resource property, and a subsidiary wholly-owned corporation of the parent had incurred foreign resource expenses before that time, paragraph 66.7(10)(*h*) of the Act generally allows the parent to designate in favour of the subsidiary any portion of its income for the year attributable to the production from such foreign resource properties. After the designation, the amount designated will, for the purpose only of claiming a deduction under the successor rules, be treated as production income of the subsidiary and not of the parent from foreign properties owned by it before the acquisition of control. In the situation where the subsidiary, rather than the parent, owns the foreign resource property after an acquisition of control this paragraph also allows the subsidiary to designate amounts in favour of its parent.

Paragraph 66.7(10)(*h*) is amended to permit designations of foreign production income to enable greater deductions to be claimed under new subsection 66.7(2.3) by the subsidiary or the parent, as the case may be.

This amendment applies to taxation years that begin after 2000.

Change of Control (Special Rules relating to Partnership Members)

ITA
66.7(10)(*j*)

Where control of a corporation is acquired and, at the time of the acquisition of control, the corporation was a member of a partnership, paragraph 66.7(10)(*j*) of the Act treats the corporation as owning, immediately before the acquisition of control, a portion of the resource property owned by the partnership at the time of the acquisition of control. The portion is equal to the corporation's percentage share of all amounts that would be paid to all members of the partnership if the partnership were wound up at the time of the

acquisition of control. In the event of a sale of these properties, the corporation would treat the proceeds as being from a disposition of resource properties owned before the acquisition of control. As a consequence, the corporation can have higher levels of "streamed income" against which to claim specified successor deductions under section 66.7.

Paragraph 66.7(10)(*j*) is amended so that successor deductions under new subsection 66.7(2.3) are likewise specified for this purpose. This amendment is consequential on the introduction of new rules for the deduction of foreign resource expenses and successor foreign resource expenses under new subsections 66.21(4) and 66.7(2.3).

This amendment applies to taxation years that begin after 2000.

Tax Consequences to Original Owner

ITA
66.7(13.1) and (13.2)

New subsection 66.7(13.1) of the Act sets out the tax consequences to an original owner of foreign resource properties who disposes of the properties in circumstances to which new subsection 66.7(2.3) applies. This subsection is structured in a manner similar to paragraphs 66.7(12)(*c*) and (*c*.1), both of which relate to successor Canadian development expense. For the purposes of the commentary below it is assumed that an original owner is party to only one transaction in a taxation year as a consequence of which its cumulative FRE is subject to the successor rules.

Under paragraph 66.7(13.1)(*a*), the original owner's cumulative FRE is reduced immediately after the succession to nil. See also in this regard the description of J in the definition "cumulative foreign resource expense" in subsection 66.21(1).

The part of the successor FRE balance considered to have been deducted by the original owner (and, as a consequence, not available to the successor) in connection with a transfer, to which new subsection 66.7(2.3) applies, at any time by the original owner is generally the specified amount determined under subsection 66.7(13.2). That subsection is parallel to paragraph 66.7(12.1)(*b*), which relates to Canadian development expenses. The specified

amount determined under subsection 66.7(13.2) represents the portion of the successor FRE balance that the original owner:

- used under paragraph 66.21(3)(*c*) in order to offset an income inclusion under paragraph 59(3.2)(*c*.1); or

- deducted under subsection 66.21(4), because of the adjustments provided under the definition "adjusted cumulative foreign resource expense" in subsection 66.21(1).

Under subparagraph 66.7(13.2)(*a*)(ii), the original owner can elect to reduce or eliminate its specified amount so that the full amount of (or a higher portion of) the original owner's cumulative FRE at the time of a succession is available to the successor.

The example below illustrates the operation of subsections 66.7(13.1) and (13.2) and related provisions.

Example

XYZ Corp. transfers all of its foreign resource properties in 2003 to Newco in circumstances to which the successor rules in section 66.7 apply. Before the transfer, XYZ's cumulative foreign resource expense (cumulative FRE) is $100,000. The proceeds of disposition of the foreign resource properties are $40,000. XYZ wants to deduct the maximum amount it can under subsection 66.21(4) for the year of the succession. XYZ incurs no further FRE after the succession, has no foreign resource production income in the year of succession and, after the succession, disposes of no foreign resource properties.

Results:

1. The potential successor FRE pool available to Newco is $60,000 (i.e., $100,000 minus $40,000). See, in this regard, the description of F in the definition "cumulative foreign resource expense" in subsection 66.21(1) and subparagraph 66.7(2.3)(a)(i). However, this potential FRE pool is reduced to the extent that XYZ claims a deduction in respect of the pool for the year of the succession.

2. XYZ's deduction under subsection 66.21(4) for the year of succession is computed with reference to its adjusted cumulative FRE under subsection 66.21 (1). This amount is computed by totalling:

- *XYZ's cumulative FRE at the end of the succession year (i.e. $100,000 (A, E) - $40,000 (F) - $60,000 (J)), which is nil; and*

- *the amount determined under paragraph 66.7(13.2)(a), which is $60,000. (It is assumed that XYZ designates no amount under subparagraph 66.7(13.2)(a)(ii). XYZ would only designate an amount under that subparagraph if it is willing to limit its ability to claim FEDE in the succession year.)*

3. XYZ claims $6,000 under subsection 66.21(4) for the year of succession.

4. Immediately after the end of the year of succession, XYZ's cumulative FRE is nil. This is equal to nil (balance at end of the year of the succession), plus $6,000 (D – which is equal to the amount determined under subsection 66.7(13.2)), minus $6,000 (E – representing deductions under subsection 66.21(4)).

5. As a consequence of XYZ's claim, clause 66.7(2.3)(a)(i)(A) and paragraph 66.7(13.1)(b), the successor FRE pool actually available to Newco is $54,000.

New subsections 66.7(13.1) and (13.2) apply to taxation years that begin after 2000.

Tax Consequences to Predecessor Owners

ITA
66.7(15.1)

New subsection 66.7(15.1) of the Act provide rules for predecessor owners similar to those in subsections 66.7(13.1) and (13.2) that apply to original owners. (A "predecessor owner" of resource properties is a corporation that acquires resource properties in circumstances to which the successor rules apply and subsequently disposes of resource properties in circumstances to which the successor rules apply.) Under paragraph 66.7(15.1)(*a*), where a

predecessor owner of foreign resource properties disposes of all or substantially all of its foreign resource properties in circumstances in which the successor rules apply, it is generally treated after the disposition as never having acquired the properties in respect of which the successor rule applied. As a consequence, the predecessor is generally precluded from claiming successor FRE deductions after the subsequent succession. Subsection 66.7(15.1) is structured in a manner that is similar to that of subsection 66.7(14).

In the case of arm's length dispositions or dispositions by way of amalgamation or merger, notwithstanding the general rule in paragraph 66.7(15.1)(*a*) the predecessor owner is allowed to claim deductions under subsection 66.7(2.3) (dealing with an original owner's foreign resource expenses) for the taxation year of the disposition. In addition, subparagraph 66.7(15.1)(*a*)(ii) ensures that paragraph 66.7(15.1)(*a*) does not have a retrospective negative impact on the value of F in the definition "cumulative foreign resource expense" in subsection 66.21(1) in respect of the predecessor owner.

Paragraph 66.7(15.1)(*b*) ensures that proceeds that subsequently become receivable by a predecessor owner will not affect the calculation of the portion of an original owner's cumulative FRE available to a subsequent successor.

New subsection 66.7(15.1) applies to taxation years that begin after 2000.

Incorporation of Definitions

ITA
66.7(18)

Subsection 66.7(18) of the Act provides that the definitions in subsection 66(15) apply to section 66.7.

Subsection 66.7(18) is amended to clarify that the definitions in sections 66.1 to 66.4, including new section 66.21, also apply to section 66.7.

This amendment applies to taxation years that begin after 2000.

Clause 31

Resource Expenses of a Limited Partner

ITA
66.8(1)

Subsection 66.8(1) of the Act provides for the reduction of a taxpayer's share of a partnership's resource expenditures incurred in a fiscal period in certain cases where the taxpayer's share of such resource expenditures exceeds the taxpayer's "at-risk amount" at the end of the fiscal period in respect of the partnership. Where there is such a reduction, subsection 66.8(2) allows the amount of the reduction to be carried forward and treated as if it were a resource expenditure incurred in the following fiscal period. The reduction of the taxpayer's resource expenditures occurs in a specified order, with a taxpayer's share of foreign exploration and development expenses being the last type of resource expenditure that is reduced.

Subsection 66.8(1) is amended so that a taxpayer's share of expenses that are a foreign resource expense in respect of a country (as defined in new section 66.21) is likewise reduced. Given the greater restrictions on the use of such expenses, the reduction is applied first to such expenses before being applied to foreign exploration and development expenses. In the event that the partnership incurred foreign resource expenses in respect of more than one country, the taxpayer can choose which country's foreign resource expenses are reduced. The Minister of National Revenue chooses the order in the event that no specification is made by the taxpayer on a timely basis.

This amendment applies to fiscal periods that begin after 2000.

Clause 32

Death of a Taxpayer

ITA
70(5.1)(*d*)

Subsection 70(5.1) of the Act deals with the transfer of a taxpayer's eligible capital property to a beneficiary on death.

Paragraph 70(5.1)(*d*), which deals with the beneficiary's gains in respect of the eligible capital property after the death of the taxpayer, is amended consequential on the re-numbering of subsection 14(1) of the Act, which is described in further detail in the commentary to that subsection.

This amendment applies to taxation years that end after February 27, 2000.

ITA
70(5.2)

Subsection 70(5.2) of the Act provides rules in respect of the disposition of resource properties and land inventories on death. Under paragraph 70(5.2)(*a*), foreign resource properties and Canadian resource properties are deemed for specified purposes to have been disposed of at fair market value immediately before the taxpayer's death. However, paragraph 70(5.2)(*b*) generally overrides paragraph 70(5.2)(*a*) in connection with property transferred or distributed to a spouse, a common-law partner or a joint spousal or common-law partner trust. Where this is the case, the taxpayer's legal representative can elect that an amount be the proceeds of disposition (to the taxpayer), and the acquisition cost (to the spouse, common-law partner or trust) of such a property. The elected amount cannot exceed the property's fair market value immediately before death. The elected amount is considered to be the proceeds of disposition and acquisition cost, respectively, of the property, to the extent that the elected amount is reflected in an amount included in computing the taxpayer's income under subsection 59(1) (in the case of foreign resource property) or in an amount that reduces the taxpayer's cumulative Canadian development expense (in the case of Canadian mining property) or the taxpayer's cumulative Canadian oil and gas property expense (in the case of Canadian oil and gas property).

Paragraph 70(5.2)(*a*) is amended so that it applies for all purposes, including new section 66.21 which deals with the calculation of a taxpayer's deductions and income inclusions in respect of foreign resource expenses.

Paragraph 70(5.2)(*a*.1) is introduced to ensure that, subject to paragraph 70(5.2)(*b*), the acquisition cost, to a taxpayer, of a resource property acquired by the taxpayer on the death of an individual, is

considered to be equal to the fair market value of the property at the time of death. This amendment applies to acquisitions that occur after 1992 and is consistent with the wording in paragraph 70(5)(*b*).

Subparagraph 70(5.2)(*b*)(ii) is amended so that the acquisition cost determined under paragraph 70(5.2)(*b*) is equal to the elected amount determined under subparagraph 70(5.2)(*b*)(i). The existing restriction with regard to foreign resource property is not appropriate in light of new subparagraph 59(1)(*b*)(ii). This amendment applies to taxation years that begin after 2000.

Clause 33

Seizure of Property by Creditors

ITA
79.1(2) and (2.1)

Section 79.1 of the Act provides the income tax consequences for creditors in connection with acquisitions and reacquisitions of property from debtors. The operative rules in section 79.1 apply only where property is seized by a creditor in respect of a debt. Under subsection 79.1(2), property is seized by a creditor in respect of a debt where the beneficial ownership of the property is acquired or reacquired by the creditor and the acquisition or reacquisition was in consequence of another person's failure to pay to the creditor all or part of the debt.

Subsection 79.1(2) is amended so that it is subject to new subsection 79.1(2.1). Subsection 79.1(2) provides that, for the purpose of section 79.1, foreign resource property is deemed not to be seized from a non-resident individual or corporation or from a partnership (other than a partnership each member of which is resident in Canada).

These amendments apply in respect of property acquired or reacquired after February 27, 2000.

Clause 34

Debt Forgiveness Rules

ITA
80

Section 80 of the Act sets out rules that deal with the forgiveness of commercial debt obligations.

Definitions

ITA
80(1)

"successor pool"

See the commentary on the amendments to subsection 80(8) of the Act.

Application of Forgiven Debt Rules

ITA
80(2)(*d*)

Paragraphs 80(2)(*d*) of the Act defines the "applicable fraction" of an unapplied portion of a forgiven amount in respect of an obligation issued by a debtor in respect of a loss for a taxation year for the purposes of section 80 of the Act.

Subparagraph 80(2)(*d*) is amended to provide that the applicable fraction of the unapplied portion of a forgiven amount in respect of an obligation issued by a debtor in respect of a loss for any taxation year, is the fraction required to be used by the taxpayer under amended section 38 for that year. The amendment is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000.

Reduction of resource expenditures

ITA
80(8)

The expression "forgiven amount" is defined in subsection 80(1) of the Act. A forgiven amount is applied as required by subsections 80(3) to (7) to reduce various tax attributes of the taxpayer. Under subsection 80(8), the unapplied portion of a debtor's forgiven amount remaining after the application of subsections 80(3) to (7) may, to the extent designated by the debtor in a prescribed form filed with the debtor's income tax return, be applied to reduce specified resource expenditure pools.

Paragraph 80(8)(*a*) is amended so that the resource expenditure pools referred to include "successor" foreign resource expenses, as determined under new subsection 66.7(2.3). The definition "successor pool" in subsection 80(1) is similarly amended.

Paragraph 80(8)(*f*) is introduced to permit the forgiven amount to be applied against a debtor's cumulative foreign resource expense in respect of a country, as determined under new section 66.21.

These amendments apply to taxation years that begin after 2000.

Capital Gain Where Current Year Capital Loss

ITA
80(12)(*a*)(ii)(B)

Subsection 80(12) of the Act treats the unapplied portion of a forgiven amount in respect of a commercial obligation of a debtor settled in a year as a capital gain of the debtor for the year from the disposition of capital property to the extent of the lesser of the amount of the remaining unapplied portion and the amount of the debtor's net capital losses for the year. In calculating the amount of the net capital losses of the debtor for the year, clause 80(12)(*a*)(ii)(B) includes 4/3 of certain deductible net capital losses of a subsidiary of the debtor that has been would up into the debtor.

Clause 80(12)(*a*)(ii)(B) is amended to replace the expression "4/3 of" with the word "twice". The amendment is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a debtor's taxation year that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in clause 80(12)(*a*)(ii)(B) is to be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the debtor for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Income Inclusion

ITA
80(13)

Subsection 80(13) of the Act includes an amount in computing the income of a debtor for the taxation year in respect the remaining unapplied portion of the forgiven amount in respect of a commercial obligation settled in the year.

The descriptions of D and E (in subparagraph (*a*)(ii) of the description of D in subsection 80(13) and paragraph (b) in the description of E in that subsection) are amended to replace references to the fraction "3/4" and the decimal "0.75" with a reference to the fraction "1/2". The amendments are consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendments apply to taxation years that end after February 27, 2000 except that, for a debtor's taxation year that includes either February 28, 2000 or October 17, 2000, the references to "1/2" in the descriptions of D and E in subsection 80(13) are to be read as references to the fraction in amended paragraph 38(*a*) of the Act that applies to the debtor for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 35

Debt Forgiveness – Subsequent Payments in Satisfaction of Debt

ITA
80.01(10)

Subsection 80.01(10) of the Act permits, in certain circumstances, a debtor to deduct an amount in computing income in respect of a payment made in respect of the principal amount of a commercial debt obligation that was previously settled.

The amendment to subsection 80.01(10) replaces the reference to the decimal "0.75" with a reference to the fraction "1/2". The amendment is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a debtor's taxation year that includes either February 28, 2000 or October 17, 2000, the reference to "1/2" in subsection 80.01(10) is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the debtor for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 36

Rule for Paragraph 84.1(2)(*a*.1)

ITA
84.1(2.1)

Subsection 84.1(2.1) of the Act provides a special rule that applies for the purpose of subparagraph 84.1(2)(*a*.1)(ii). Paragraph 84.1(2)(*a*.1) provides a rule for the purpose of determining the adjusted cost base to a taxpayer of a share for the purposes of section 84.1.

Subsection 84.1(2.1) is amended by replacing the references to the expressions "4/3 of" with references to the word "twice" and by replacing the reference to the fraction "3/4" with a reference to the

fraction "1/2". The amendments are consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendments apply to taxation years that end after February 27, 2000 except that, for a taxpayer's taxation year that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in subsection 84.1(2.1) is to be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the taxpayer for the year, multiplied by" and the reference to the fraction "1/2" is to be read as a reference to the fraction in amended paragraph 38(*a*) that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 37

Transfer of Property to Corporation by Shareholders

ITA
85

Section 85 of the Act provides for tax-deferred transfers of certain types of properties by a taxpayer to a taxable Canadian corporation in exchange for shares.

ITA
85(1)(*d*.1)

Subsection 85(1) of the Act provides a tax deferral for the transfer of various types of property by a taxpayer to a taxable Canadian corporation for consideration that includes shares of the corporation's capital stock. Paragraph 85(1)(*d*.1) provides specific rules to ensure that the tax accounts relating to eligible capital property in respect of a business are carried through from the transferor to the transferee. Descriptions D and E in paragraph 85(1)(*d*.1) are amended consequential on the re-numbering of subsection 14(1) of the Act, which is described in further detail in the commentary to that subsection.

These amendments apply to taxation years that end after February 27, 2000.

ITA
85(1.11)

Subsection 85(1.1) describes the types of property (referred to in the Act as "eligible property") that may be transferred to a corporation under subsection 85(1).

New subsection 85(1.11) provides that a foreign resource property (or an interest in a partnership that derives all or part of its value from one or more foreign resource properties) is not an "eligible property" of a taxpayer in respect of a transfer to a corporation where:

- the taxpayer and the corporation do not deal with each other at arm's length; and

- it is reasonable to conclude that one of the purposes of the disposition, or a series of transactions or events of which the disposition is a part, is to increase the extent to which any person may claim a deduction under section 126. (An increase of a deduction under section 126 could arise as a consequence of a reduction of an amount that the person deducts, or is entitled to deduct, under any combination of subsections 66(4), 66.21(4) and 66.7(2) and (2.3).)

This provision is intended to counter the avoidance of income-based limits on the foreign tax credit in section 126 that might be achieved through the sale of direct or indirect interests in foreign resource property at less than fair market value. In general terms, under subsection 126(2) the level of a foreign tax credit for a taxpayer in respect of a business carried on in a foreign country cannot exceed a specified percentage of the taxpayer's Canadian income tax. The specified percentage is essentially the percentage that the taxpayer's "qualifying income" from that business is of the taxpayer's world-wide income. (New subsection 126(9) reinforces the "qualifying income" limit for foreign tax credits by generally requiring a taxpayer to maximize foreign exploration and development expense deductions and foreign resource deductions for the purpose of computing qualifying income.)

This amendment applies to transfers that occur after Announcement Date.

Clause 38

Foreign Spin-Offs

ITA
86.1

New section 86.1 of the Act allows for a tax deferral, generally on an elective basis, in respect of certain foreign distributions of spin-off shares by a foreign corporation that are received by Canadian resident shareholders of the foreign corporation. The rules in new section 86.1 are described below and may be applied to otherwise taxable distributions received after 1997.

Eligible Distribution Not Included in Income

ITA
86.1(1) and (2)

New subsection 86.1(1) of the Act provides that an amount in respect of an "eligible distribution" of spin-off shares received by a taxpayer is not to be included in computing the taxpayer's income. Further, the cost of those shares to the taxpayer is not their fair market value as otherwise provided by subsection 52(2) of the Act. Rather, the cost of the original share which generated the distribution of the spin-off share will be allocated amongst the two.

New subsection 86.1(2) defines an "eligible distribution". A distribution of spin-off shares to a taxpayer is an "eligible distribution" only if a number of conditions are met.

First, the distribution to the taxpayer must be because the taxpayer owns common shares in the distributing corporation (i.e., the "original shares").

Second, the distribution to the taxpayer must consist solely of common shares of the capital stock of another corporation owned by the distributing corporation (i.e., the "spin-off shares") – the distribution to the taxpayer must not include non-share consideration.

Third, in the case of a distribution made by a corporation in the United States,

- both the distributing corporation and the spun-off corporation (the issued shares of which are being spun-off) must be resident of the United States at the time of the distribution and must never have been resident in Canada,

- the taxpayer's original shares must be included in a class of stock that is widely held and actively traded on a prescribed stock exchange (section 3201 of the Regulations) in the United States at the time of the distribution, and

- the shareholders of the distributing corporation that are resident in the United States must not be taxable in respect of the distribution under the United States Internal Revenue Code.

Fourth, in the case of a distribution that is not in the United States and that is prescribed by regulation,

- both the distributing corporation and the spun-off corporation (the issued shares of which are being spun-off) must be resident of the same foreign country, other than the United States, with which Canada has a tax treaty and those corporations must never have been resident in Canada,

- the taxpayer's original shares must be included in a class of stock that is widely held and actively traded on a prescribed stock exchange (section 3201 of the Regulations) at the time of the distribution,

- under the law of the country in which the distributing corporation is resident, the shareholders of the distributing corporation must not be taxable in respect of the distribution, and

- such terms and conditions as are considered appropriate in the circumstances with respect to the prescription must be met.

Fifth, the distributing corporation must provide the Minister of National Revenue, within six months of the distribution, evidence satisfactory to the Minister of certain matters including the type and fair market value of each property distributed to residents of Canada

and the name and address of each resident of Canada that received property because of the distribution. Property that is distributed to residents of Canada includes, for example, property that is distributed to investment dealers resident in Canada as well as individual and corporate shareholders.

Sixth, generally the taxpayer acquiring the spin-off shares must elect in writing (filed with the taxpayer's return of income for the year in which the distribution occurs) to have section 86.1 apply to the distribution and provide evidence satisfactory to the Minister of National Revenue of certain matters relating to the distribution and the taxpayer.

The information submitted to the Minister must establish, for example, the number, cost amount and fair market value of the taxpayer's original shares immediately before the distribution, and the number, and the fair market value, of the spin-off shares immediately after the distribution. Furthermore, in the case of a distribution received before October 18, 2000, while the election must be filed in writing with the Minister, it need not be included in the taxpayer's return of income for the year in which the distribution occurs.

Information filed by the corporation or the taxpayer under paragraph 86.1(2)(*e*) or (*f*) in respect of a distribution that occurred before these provisions receive Royal Assent will be considered to have been filed on time if it is filed within 90 days of that Royal Assent

However, if the taxpayer acquiring the spin-off shares is a taxpayer to which Part XI of the Act applies, no election is required and the cost adjustment rules will apply automatically where the conditions of subsections 86.1(2) and (3) are satisfied. Part XI provides that certain deferred income trusts, pension trusts and corporations, registered investments and persons exempt from Part I tax (e.g., an employees profit sharing plan) will generally be subject to a special tax on foreign property or certain rights to acquire shares. For more detail on the foreign property rule, see the commentary on Part XI.

A trust or corporation referred to in Part L of the *Income Tax Regulations* is also subject to foreign property limits. However, because Part XI of the Act does not apply in respect of such a trust or corporation, the trust or corporation must meet all of the requirements of section 86.1, including the requirement to file an

election, in order for that section to apply for the purposes of Part I of the Act and the foreign property limits in Part L of the Regulations.

Cost Adjustments

ITA
86.1(3)

New subsection 86.1(3) of the Act provides two rules that adjust the cost amount of a taxpayer's original shares, and spin-off shares received on an eligible distribution.

New paragraph 86.1(3)(*a*) provides a formula for computing the amount that is to be deducted from the cost amount of a taxpayer's original share. The amount to be deducted from the cost amount of each original share is determined by the formula:

$$A \times (B/C)$$

where

A is the cost amount to the taxpayer of the original share (determined without reference to section 86.1),

B is the fair market value of the spin-off share immediately after its distribution to the taxpayer,

C is the total of

- the fair market value of the original share immediately after the distribution of the spin-off share to the taxpayer, and

- the fair market value of spin-off share immediately after its distribution to the taxpayer.

New paragraph 86.1(3)(*b*) provides that the cost of a taxpayer's spin-off share is equal to the amount deducted from the cost amount of the taxpayer's original share.

Example:

Assume:

John owns one original common share of DC Ltd. (resident in the U.S.), which distributes one spin-off share of SO Ltd. (also resident in the U.S.) on a per share basis to holders of common shares of DC Ltd. The cost amount of John's original share of DC Ltd. is $10 immediately before the distribution and its fair market value immediately after the distribution is $70. The fair market value of the SO Ltd. spin-off share is $30 immediately after the distribution.

Application of subsection 86.1(3):

- *The cost amount of John's original share in DC Ltd. is reduced to $7 – i.e., the $10 cost amount less the $3 amount deducted because of paragraph 86.1(3)(a).*

    - *$10 – (A x (B/C))*

        A = *$10.*
        B = *$30.*
        C = *$100 (= $70+$30).*

- *The cost of John's spin-off share in SO Ltd. is $3 because of paragraph 86.1(3)(b).*

The adjustments in subsection 86.1(3) to the cost amount of an original share and spin-off share apply for all purposes of the Act, including the foreign property rule contained in Part XI of the Act. The application for purposes of the foreign property rule in Part XI of the Act will ensure that the level of foreign property held by a taxpayer subject to that rule is not affected solely because of an eligible distribution.

Inventory

ITA
86.1(4)

New subsection 86.1(4) provides rules that apply for the purpose of calculating the value of property (an original share and a spin-off share) described in an inventory of a taxpayer's business. New paragraph 86.1(4)(*a*) provides that a spin-off share that is included in such an inventory is deemed not to be an acquisition of property in the fiscal period of the business in which the distribution occurs. This rule is intended to exclude the cost of the spin-off share from the cost of inventory acquired the year, as the cost of the spin-off shares will normally be reflected in the cost of the original share.

New paragraph 86.1(4)(*b*) provides that, for greater certainty, the value of the spin-off share is to be included in computing the value of that inventory at the end of the fiscal period.

Reassessments

ITA
86.1(5)

New subsection 86.1(5) allows the Minister of National Revenue to make such reassessments, determinations and redeterminations as are necessary where information is obtained that the conditions in subparagraph 86.1(2)(*c*)(iii) or (2)(*d*)(iii) are not, or are no longer, satisfied. Those conditions are more fully described in the commentary to new subsection 86.1(2).

Clause 39

Amalgamations

ITA
87(1.2)

Section 87 of the Act sets out rules that apply where there has been an amalgamation of two or more taxable Canadian corporations to form a new corporation.

Where there has been an amalgamation of two or more corporations, the successor rules in section 66.7 generally provide that unclaimed resource expenditures of a predecessor corporation may be deducted by the new corporation only within the limitations of the successor rules (i.e., against "streamed income" related to the predecessor corporation's resource properties). However, under subsection 87(1.2) the successor rules do not apply where there has been an amalgamation of a corporation and one or more of its subsidiary wholly-owned corporations (as defined by subsection 87(1.4)) or an amalgamation of two or more corporations which are subsidiary wholly-owned corporations of the same corporation.

Subsection 87(1.2) is amended so that the same exception applies in respect of foreign resource expenses calculated under new section 66.21.

This amendment applies to amalgamations that occur after 2000.

Clause 40

Winding-up of a Corporation

ITA
88(1.5)

Section 88 of the Act deals with the tax consequences arising from the winding-up of a corporation. Where there has been a winding-up of a subsidiary into a parent corporation that owned at least 90% of the subsidiary's shares, subsection 88(1.5) provides that the parent is considered to be the same corporation as the subsidiary for the purpose of the provisions dealing with the deduction of exploration, development and resource property expenses. This effectively removes the restrictions of the successor corporation rules that would otherwise apply with respect to the deduction by the parent of the unclaimed resource expenses of the subsidiary following its winding-up.

Subsection 88(1.5) is amended so that the same rule also applies in respect of foreign resource expenses calculated under new section 66.21.

This amendment applies to windings-up that occur after 2000.

Clause 41

Capital Dividend Account – Definition

ITA
89(1)

"capital dividend account"

Where the appropriate elections have been made by a private corporation, dividends paid out of its capital dividend account are received tax-free by the corporation's shareholders who are resident in Canada. A corporation's capital dividend account includes the untaxed portion of gains in respect of dispositions of capital property.

Paragraph (*c*) of the definition "capital dividend account" describes the "untaxed portion" of gains in respect of eligible capital property. Because, under existing paragraph 14(1)(*b*) of the Act, a corporation's gain in respect of eligible capital property was previously aggregated with a recapture of the paragraph 20(1)(*b*) deductions that were previously claimed, paragraph (*c*) of the definition "capital dividend account" describes the untaxed portion of gains in respect of eligible capital property by reference to the corporation's cumulative eligible capital, eligible capital expenditures and variable E in the definition "cumulative eligible capital".

Amended paragraph 14(1)(*b*) identifies the taxable (2/3 for taxation years that end after February 27, 2000 and before October 18, 2000 and 1/2 for taxation years that end after October 17, 2000) portion of gains in respect of eligible capital property. Accordingly it is possible to simplify the description of the untaxed (1/3) portion of gains in respect of eligible capital property for taxation years that end after February 27, 2000 and before October 18, 2000 and (1/2) portion for taxation years that end after October 17, 2000. Paragraph (*c*) of the definition "capital dividend account" is therefore amended to describe amounts determined under that provision as it applied to taxation years that ended before February 28, 2000.

New paragraph (*c*.1) of the definition "capital dividend account" generally requires the inclusion in the capital dividend account of 1/2 of all amounts required by amended paragraph 14(1)(*b*) of the Act to be included in the corporation's income for taxation years that end after February 27, 2000 and before October 18, 2000.

New paragraph (*c*.2) of the definition requires the inclusion of the amount required by paragraph 14(1)(*b*) of the Act (as amended) to be included for taxation years that end after October 17, 2000.

Both these amounts are reduced to take into account the appropriate portion of bad debts in respect of dispositions of eligible capital property. The calculation of the reduction for bad debts is complicated by the interaction of different inclusion rates for capital gains that may be relevant during the period. New paragraphs (*c*.1) and (*c*.2) of the definition "capital dividend account" recognize both the deduction under subsection 20(4.2) and the deemed allowable capital loss under subsection 20(4.3) as amounts that reduce the capital dividend account. For further detail, see the commentary on subsections 20(4.2) and (4.3) of the Act.

These amendments apply in respect of taxation years that end after February 27, 2000.

Clause 42

Loss Limitation on Disposition of Share

ITA
93(2)

Subsection 93(2) of the Act provides a rule for the purpose of determining a loss of a corporation resident in Canada or a foreign affiliate of such a corporation from the disposition of a share of another foreign affiliate of the corporation. The loss is reduced by exempt dividends received on the share.

The amendment to subsection 93(2) replaces the reference to the expression "4/3 of" with a reference to the word "twice", as a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment generally applies to taxation years that end after February 27, 2000. For a taxation year of a corporation that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in subsection 93(2) is to be read as reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the taxpayer for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Loss Limitation – Disposition of Share by Partnership

ITA
93(2.1)

New subsection 93(2.1) of the Act provides a rule for the purpose of determining a loss of a corporation resident in Canada or a foreign affiliate of such a corporation from the disposition by a partnership of a share of another foreign affiliate of the corporation. The loss is reduced by exempt dividends received on the share.

The amendment to subsection 93(2.1) replaces the reference to the fraction "3/4" with a reference to the fraction "1/2", as a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment generally applies to taxation years that end after February 27, 2000. For a taxation year of a corporation that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in subsection 93(2) is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Loss Limitation – Disposition of Partnership Interest

ITA
93(2.2)

Subsection 93(2.2) of the Act provides a rule for the purpose of determining a loss of a corporation resident in Canada or a foreign affiliate of such a corporation from the disposition of an interest in a partnership owning a share of another foreign affiliate of the

corporation. The loss is reduced by exempt dividends received on the share.

The amendment to subsection 93(2.2) replaces the reference to the expression "4/3 of" with a reference to the word "twice", as a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment generally applies to taxation years that end after February 27, 2000. For a taxation year of a corporation that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in subsection 93(2.2) is to be read as reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the taxpayer for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Loss Limitation – Disposition of Partnership Interest

ITA
93(2.3)

Subsection 93(2.3) of the Act provides a rule for the purpose of determining a loss of a corporation resident in Canada or a foreign affiliate of such a corporation from the disposition by a partnership of a share of another foreign affiliate of the corporation. The loss is reduced by exempt dividends received on the share.

The amendment to subsection 93(2.3) replaces the reference to the fraction "3/4" with a reference to the fraction "1/2", as a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment generally applies to taxation years that end after February 27, 2000. For a taxation year of a corporation that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in subsection 93(2.3) is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 43

Foreign Affiliates

ITA
95

Section 95 of the Act defines a number of terms and provides certain rules relating to the taxation of resident shareholders of foreign affiliates.

Definitions

ITA
95(1)

"foreign accrual property income"

The description of A.1 in the definition "foreign accrual property income" in subsection 95(1) of the Act includes in the foreign accrual property income of a foreign affiliate of a taxpayer 4/3 of the amount required in respect of a debt settlement to be added to the affiliate's income because of subsection 80(13) of the Act.

The description of A.1 is amended to replace the reference to the expression "4/3 of" with a reference to the word "twice". The change is consequential on the reduction of the capital gains inclusion rate from 3/4 to 1/2.

The amendment generally applies to taxation years that end after February 27, 2000 except that, where the affiliate's taxation year includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in the description of A.1 in the definition "foreign accrual property income" in subsection 95(1) is to be read as a reference the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the foreign affiliate for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Foreign Spin-off Election

ITA
95(2)(*g*.2)

Subsection 95(2) of the Act provides rules for determining the income of a foreign affiliate of a taxpayer resident in Canada. These rules apply for the purposes of sections 90 to 95 of the Act.

New paragraph 95(2)(*g*.2) of the Act is added as a consequence of the introduction of the foreign spin-off tax-deferral rules in new section 86.1. Paragraph 95(2)(*g*.2) applies for the purpose of computing the foreign accrual property income of a foreign affiliate of any taxpayer resident in Canada for a taxation year of the affiliate. New paragraph 95(2)(*g*.2) deems an election pursuant to paragraph 86.1(2)(*f*) in respect of a distribution received by the foreign affiliate (in a particular taxation year of the affiliate) to have been filed under that paragraph in two cases.

First, where there is only one taxpayer resident in Canada in respect of whom the foreign affiliate is a controlled foreign affiliate, section 86.1 applies to the distribution received by the foreign affiliate if the election is filed by that taxpayer with the taxpayer's return of income for the taxpayer's taxation year in which the taxation year of the affiliate ends.

Second, where there is more than one taxpayer resident in Canada in respect of whom the affiliate is a controlled foreign affiliate, section 86.1 applies to the distribution received by the foreign affiliate if the election is filed by one such taxpayer and all such taxpayers so agree in writing and file that agreement and the election with the Minister in each of their returns of income for their taxation year in which the taxation year of the affiliate ends.

For more detail in respect of the foreign spin-off rules, see the commentary on new section 86.1.

New paragraph 95(2)(*g*.2) applies, in general, to distributions received after 1997.

Clause 44

Partnerships and Their Members

ITA
96

Section 96 of the Act provides general rules for determining the income or loss of a partnership and its members.

General rules

ITA
96(1)(*d*)

Under subsection 96(1) of the Act, the income earned and the losses incurred by a partnership are generally calculated at the partnership level and attributed to partners in accordance with their respective interests. However, under paragraph 96(1)(*d*) the income or loss of a partnership is computed without reference to a number of provisions including various provisions relating to resource income and expenditures.

Paragraph 96(1)(*d*) is amended so that income inclusions under subsection 59(1) (dispositions of foreign resource property) and paragraph 59(3.2)(*c*.1) are ignored for this purpose. Instead, under new subsections 59(1.1) and 66(12.42), there is a flow-through to a member of a partnership of the member's share of proceeds of disposition of foreign resource property and of other relevant amounts receivable.

Paragraph 96(1)(*d*) is also amended to ignore deductions under new section 66.21, given that a partner's share of foreign resource expenses qualifies under paragraph (*e*) of the definition "foreign resource expense" in subsection 66.21(1) as the partner's own foreign resource expenses.

These amendments apply to fiscal periods that begin after 2000.

Gains and Losses

ITA
96(1.7)

Subsection 96(1.7) of the Act applies to a taxpayer other than an individual who is not a testamentary trust and adjusts the amount of a partnership's taxable capital gain or allowable capital loss included in a taxpayer's income where the taxpayer's capital gains inclusion rate for the taxpayer's taxation year in which the partnership's fiscal period ends is different from the partnership's inclusion rate used to calculate the partnership's taxable capital gain or allowable capital loss.

The adjusted taxable capital gain or allowable capital loss reflects the taxpayer's inclusion rate for the taxpayer's taxation year in which the fiscal period of the partnership ends. This is necessary since a taxpayer may have other taxable capital gains or allowable capital losses and all taxable capital gains and allowable capital losses should be calculated using the same inclusion rate.

The subsection is amended to make the subsection apply in respect of all taxpayers. The amendment applies to the 2000 and subsequent taxation years that end after February 27, 2000.

Limited Partnership Losses

ITA
96(2.1)(*b*)(iv)(A)

Subsection 96(2.1) of the Act deals with the losses of limited partnerships. That subsection generally limits the deduction by a limited partner of losses to an amount equal to the amount by which the limited partner's "at-risk amount" in respect of a partnership exceeds the partner's share of specified resource expenditures flowed-through to the partner. Under clause 96(2.1)(*b*)(iv)(A), the resource expenditures specified include foreign exploration and development expenses.

Clause 96(2.1)(*b*)(iv)(A) is amended to specify "foreign resource pool expenses", as newly defined in subsection 248(1), rather than only foreign exploration and development expenses. The new definition

"foreign resource pool expenses" includes both foreign exploration and development expenses (as defined in subsection 66.21(1)) and expenses that are a foreign resource expense (as defined in subsection 66.21(1)).

This amendment applies to fiscal periods that begin after 2000.

Clause 45

Disposition of Partnership Property

ITA
98

Section 98 provides rules relating to the taxation of partnership properties and partnership interests where the partnership has ceased to exist.

ITA
98(3)

Subsection 98(3) of the Act is an elective provision permitting property of a Canadian partnership which has ceased to exist to be distributed to its members, for proceeds to the partnership and at a cost to the members, equal to the cost amount of the property to the partnership, provided certain conditions are met. Where those conditions are met, this provision allows a special increase or "bump-up" in the tax value of the distributed partnership property where the adjusted cost base of a member's partnership interest exceeds the amount of any money and the cost amount to the partnership of the property which the member has received upon the dissolution.

Subparagraph 98(3)(*g*)(iii) prevents an overstatement of the income inclusions under existing subparagraph 14(1)(*a*)(v) and existing paragraph 14(1)(*b*) of the Act. Subparagraph 98(3)(*g*)(iii) is amended consequential on the re-numbering of subsection 14(1), which is described in further detail in the commentary to that subsection.

This amendment applies to taxation years that end after February 27, 2000.

ITA
98(5)

Subsection 98(5) of the Act contains rules which provide a tax-deferred transfer or "rollover" of a Canadian partnership's property where the partnership has ceased to exist and the transfer is to one member of the partnership who continues to carry on the business of the partnership as a sole proprietor.

Where the adjusted cost base of the member's partnership interest, including the interests acquired from other members, exceeds the amount of any money and the cost amount to the partnership of the property received by the proprietor upon the dissolution, the member may designate this excess to be added to the cost base of one of more particular properties.

Subparagraph 98(5)(*h*)(ii) prevents an overstatement of the income inclusions under subparagraph 14(1)(*a*)(v) or paragraph 14(1)(*b*) of the Act. Subparagraph 98(5)(*h*)(ii) is amended consequential on the re-numbering of subsection 14(1), which is described in further detail in the commentary to that subsection.

This amendment applies to taxation years that end after February 27, 2000.

Clause 46

Disposition of an Interest in a Partnership

ITA
100(1)(*a*)

Subsection 100(1) of the Act provides a rule for the purpose of determining a taxpayer's gain from the disposition of an interest in a partnership to a person part or all of whose taxable income is exempt from tax under section 149 of the Act.

Paragraph 100(1)(*a*) is amended to replace the reference to the fraction "3/4" with a reference to the fraction "1/2". The change is consequential on the reduction in the capital gains inclusion rate.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in paragraph 100(1)(*a*) is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 47

Disposition of Farmland by Partnership

ITA
101

Section 101 of the Act provides for a deduction in computing the income of a taxpayer for a taxation year of the taxpayer in which a fiscal period of a partnership ends where, in that fiscal period, the partnership has sold land used in farming. The deduction is equal to 3/4 of the farm losses that, because of section 31, were not deductible and that relate property taxes in respect of and interest on money borrowed to acquire the farmland sold. The amendments to subsection 101(1) replace the reference to the fraction "3/4" with a reference to the fraction "1/2" and the reference to the expression "4/3 of" with references to the word "twice". The changes are consequential on the reduction of the capital gains inclusion rate from 3/4 to 1/2.

The amendments apply to taxation years that end after February 27, 2000 except that, where the taxation year of the partnership that ends in the taxation year of the taxpayer includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" in subsection 101(1) is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the taxpayer's taxation year in which the taxation year of the partnership ended. The reference to the word "twice" in subsection 101(1) is to be read as a reference the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the partnership for the fiscal period, multiplied by".

Clause 48

Trusts

ITA
104

Section 104 of the Act provides rules governing the tax treatment of trusts and their beneficiaries.

Rules for Trusts

ITA
104(5.2)

Subsection 104(5.2) of the Act provides that each Canadian resource property and foreign resource property of a trust is treated, for specified purposes, as having been disposed of immediately before the end of a day determined under subsection 104(4) for fair market value proceeds. For the purposes of specified resource provisions, the trust is treated as having a taxation year (referred below to as the "notional year") ending at the end of such a day for the purpose of computing the amount to be included in its income as a result of this disposition of the resource properties. The Canadian and foreign resource properties are deemed to be reacquired immediately after notional year for the same amount.

Paragraph 104(5.2)(*a*) is amended to include new paragraph 59(3.2)(*c*.1) and the new definition "cumulative foreign resource expense" in new section 66.21 in the resource provisions specified under subsection 104(5.2).

Paragraph 104(5.2)(*b*) is amended so that any resulting income inclusion under new paragraph 59(3.2)(*c*.1) with regard to the notional year is added in determining the trust's cumulative foreign resource expense at the end of the trust taxation year of which the notional year is part. This amendment ensures that there is no double taxation in respect of the same economic gain and is consistent with the treatment of resulting income inclusions with regard to Canadian resource properties.

The effect of these amendments is that the fair market value of a foreign resource property can, to the extent proceeds are designated under new subparagraph 59(1)(*b*)(ii), reduce a trust's cumulative foreign resource expense. If a negative balance results, the negative balance is included in income under paragraph 59(3.2)(*c*.1) and added in computing the trust's cumulative foreign resource expense after the end of the notional year.

These amendments apply to taxation years that begin after 2000.

Deemed gains

ITA
104(21.4)

New subsection 104(21.4) of the Act provides a special rule that applies where a trust designates for its taxation year that includes either February 28, 2000 or October 17, 2000 an amount in respect of a beneficiary (the allocated gain) that is deemed because of subsection 104(21) to be a taxable capital gain of the beneficiary for the taxation year of the beneficiary in which the trust's year ends. The subsection provides that

- the beneficiary is deemed to have a capital gain (deemed gain) equal to the amount if any by which

  (a) the amount determined when the allocated gain is divided by the fraction in amended paragraph 38(*a*) that applies to the trust for the year

  exceeds

  (b) the amount claimed by the beneficiary, not exceeding the beneficiary's exempt capital gain balance for the year in respect of the trust, and

- notwithstanding subsection 104(21), the allocated gain is not included in the income of the beneficiary otherwise than because of the application of this subsection.

The trust is required to disclose to the beneficiary the portion of the deemed gain that is paid out of gains of the trust for each of the pre-

February 28, 2000 period, the period that begins at the beginning of February 28, 2000 and ends at the end of October 17, 2000 and the period that begins after October 17, 2000 and, in the event that this is not done, the gains are deemed to be pre-February 28, 2000 gains. Where the trust elects, it can treat its gains as having been realized equally over the number of days in its taxation year, so that the gains in each of the periods will be equal that proportion of the deemed gains that the number of days in the year of the trust that are in each period is of the number of days in the year. This subsection applies to taxation years that end after February 27, 2000.

Clause 49

Interests in Trusts

ITA
107

Section 107 of the Act provides certain rules relating to the acquisition and disposition of interests in, and the property of, trusts.

Capital Interest Distribution by Personal or Prescribed Trust

ITA
107(2)(*f*)(ii)

Section 107 of the Act provides certain rules relating to the acquisition and disposition of interests in, and the property of, trusts.

Subsection 107(2) provides a rollover on the distribution of property from a personal or prescribed trust to a beneficiary in satisfaction of all or part of the beneficiary's capital interest in such a trust.

Paragraph 107(2)(*f*) is intended to prevent an overstatement of the income inclusions under subparagraph 14(1)(*a*)(v) or paragraph 14(1)(*b*) of the Act, on the subsequent disposition of eligible capital property by the beneficiary. Paragraph 107(2)(*f*) is amended consequential on the re-numbering of subsection 14(1), which is described in further detail in the commentary to that subsection.

This amendment applies to taxation years that end after February 27, 2000.

Flow-Through Entity

ITA
107(2.2)

Subsection 107(2.2) of the Act provides for an addition to the cost base of property received by a taxpayer from a trust in satisfaction of the taxpayer's interest in the trust where the exempt capital gains balance of the taxpayer in respect of the trust has not been fully utilised.

The amendment to subparagraph 107(2.2)(*a*)(ii) replaces the reference to the expression "4/3 of" with a reference to the word "twice" and is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" in subparagraph 107(2)(*a*)(ii) is to be read as reference to the fraction that is the reciprocal of the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 50

Qualifying Disposition

ITA
107.4(3)(*e*)(ii)

Subsection 107.4(3) of the Act applies where there has been a "qualifying disposition" of property. As set out in subsection 107.4(1), a "qualifying disposition" of property is a disposition that does not result in any change in the beneficial ownership of the property and that otherwise meets the conditions set out in that subsection. Subsection 107.4(3) generally provides for the rollover of

property on the disposition. Subparagraph 107.4(3)(*e*)(ii), which is intended to prevent an overstatement of the income inclusions required by subsection 14(1), is amended consequential on the re-numbering of subsection 14(1), which is described in further detail in the commentary to that subsection.

This amendment applies to taxation years that end after February 27, 2000.

Clause 51

Taxable Income – Deductions

ITA
110

Section 110 of the Act provides various deductions that may be claimed in computing a taxpayer's taxable income.

Employee Options

ITA
110(1)(*d*)

Paragraph 110(1)(*d*) of the Act provides a deduction in computing taxable income when an employee is deemed, by subsection 7(1) of the Act, to have received a benefit from employment in connection with the exercise or disposition of rights under an employee option agreement. The deduction is equal to 1/4 of the amount of the employment benefit. The effect of the deduction is to have the benefit taxed at a rate equivalent to the capital gains inclusion rate.

In order to qualify for the deduction under paragraph 110(1)(*d*), the following three conditions must be satisfied:

- The security that is the subject of the option must be either a prescribed share (as defined in section 6204 of the Regulations) or a unit of a widely-held class of units of a mutual fund trust. This condition is set out in subparagraph 110(1)(*d*)(i).

- The exercise price (that is, the amount payable by the employee to acquire the security under the option) must be at least equal to the fair market value of the security when the option was granted (less any amount paid by the employee to acquire the option). If the option being exercised or disposed of was acquired by the employee as a result of one or more exchanges of options to which subsection 7(1.4) applied, this condition applies to the original option. This condition is set out in clauses 110(1)(*d*)(ii)(A) and (iii)(A), and is referred to in these notes as the "exercise price test".

- At the time immediately after the option was granted, the employee must have been dealing at arm's length with the entity granting the option (the "grantor") and with each entity not dealing at arm's length with the grantor. If the option being exercised or disposed of was acquired by the employee as a result of one or more exchanges to which subsection 7(1.4) applied, this condition applies to each new option, but not to the original option. This condition is set out in clauses 110(1)(*d*)(ii)(B) and (iii)(B), and is referred to in these notes as the "arm's length test".

Paragraph 110(1)(*d*) is amended in the following ways.

Amount of Deduction

Paragraph 110(1)(*d*) is amended as a consequence of changes to the capital gains inclusion rate. Specifically, the deduction that an employee may claim under this paragraph is increased from 1/4 to 1/3 of the amount of the employment benefit that the employee is deemed, by subsection 7(1) of the Act, to have received, if the transaction which results in the recognition of the employment benefit occurs after February 27, 2000 and before October 18, 2000. Similarly, if the transaction occurs after October 17, 2000, the deduction is increased to 1/2.

Where an employee acquires an option security under circumstances to which subsection 7(1.1) or (8) applies, it is the disposition of the security which results in the recognition of the employment benefit, and thus determines the amount of the deduction available under paragraph 110(1)(*d*). In all other cases, it is the exercise or disposition of the option which results in the recognition of the

benefit, and thus determines the amount of the deduction available under paragraph 110(1)(*d*).

Example

A share acquired in June 2000 under an employee option granted by a Canadian-controlled private corporation (CCPC) is sold in November 2000. In accordance with subsection 7(1.1), the sale of the share results in the employee being deemed, by subsection 7(1), to have received a benefit from employment. Since the sale occurred after October 17, 2000, the deduction available under paragraph 110(1)(d) would be 1/2 of the employment benefit.

If the share were acquired under a non-CCPC option and there were no deferral under subsection 7(8), the acquisition of the share would result in the recognition of the benefit. Since the acquisition occurred after February 27 but before October 18, 2000, the deduction available under paragraph 110(1)(d) would be 1/3 of the employment benefit.

Exercise Price Test

Paragraph 110(1)(*d*) is amended to ensure that the condition relating to the exercise price under an employee option accommodates an exchange of options in accordance with subsection 7(1.4) of the Act and a subsequent repricing of the new option.

Specifically, subparagraph 110(1)(*d*)(iii) – which applies when the option being exercised or disposed of was acquired by the employee as a result of one or more exchanges of options in accordance with subsection 7(1.4) – is amended to require that the following conditions be satisfied:

- The closing exercise price under the original option (that is, the exercise price under the original option at the time it was exchanged) must not be less than the fair market value of the underlying security at the time the option was granted minus any amount paid by the employee to acquire the option. This condition is set out in new clause 110(1)(*d*)(iii)(C) and essentially replicates the condition currently set out in clause 110(1)(*d*)(iii)(A).

- For each subsequent exchange, the closing exercise price under the option being given up must not be less than the opening exercise price under that option (that is, the exercise price that was set under that option when it was granted). This condition is set out in new clause 110(1)(*d*)(iii)(D).

- For the option which is being exercised or disposed of (and which is, thus, giving rise to the deemed employment benefit under subsection 7(1)), the exercise price at the time of exercise or disposition, as the case may be, must not be less than the opening exercise price under that option. This condition is set out in amended clause 110(1)(*d*)(iii)(A).

In applying these conditions, reference must be made to subsection 7(1.4). That subsection provides that, where there is an exchange of employee security options within a related group (or on a corporate amalgamation or merger), the exchange is disregarded for the purposes of section 7 so long as the employee derives no economic gain from the exchange. As a consequence of the application of subsection 7(1.4), the disposition of the old options does not give rise to an employment benefit under subsection 7(1).

In determining whether or not an employee has derived an economic gain from an exchange of options, paragraph 7(1.4)(*c*) compares the potential benefit under the new options to the potential benefit under the old options.

- The potential benefit under the new options is determined by subtracting the total exercise price under those options immediately after the exchange (subparagraph 7(1.4)(*c*)(ii)) from the total value at that time of the securities underlying those options (subparagraph 7(1.4)(*c*)(i)). This is relevant for amended subparagraph 110(1)(*d*)(iii) in that the amount included in subparagraph 7(1.4)(*c*)(ii) on a per-security basis represents the opening exercise price under those options.

- The potential benefit under the old options is determined by subtracting the total exercise price under those options immediately before the exchange (subparagraph 7(1.4)(*c*)(iv)) from the total value at that time of the securities underlying those options (subparagraph 7(1.4)(*c*)(iii)). This is relevant for amended subparagraph 110(1)(*d*)(iii) in that the amount included in

subparagraph 7(1.4)(*c*)(iv) on a per-security basis represents the closing exercise price under those options.

It should be noted that amended subsection 110(1.5) of the Act contains a number of provisions that affect the calculation of amounts for the purposes of paragraph 110(1)(*d*). Specifically, it provides for currency fluctuations to be disregarded in determining the exercise price under an option. (This is currently provided for in paragraph 110(1)(*d*), but is being moved to subsection 110(1.5).) It also provides for the fair market value of an employee option security, and the opening exercise price under an option acquired in an exchange of options, to be adjusted for structural changes (such as a split or consolidation of shares) occurring after the option is granted. (See the commentary on amended subsection 110(1.5) for further details.)

Arm's Length Test

The arm's length test is amended in two ways.

First, the entities with which the employee must be dealing at arm's length is narrowed. Rather than having to be at arm's length with the grantor and any entity not dealing at arm's length with the grantor, the employee must be at arm's length with the grantor, the employer and the entity whose securities can be acquired under the option. This is less restrictive than the existing condition in that an employee who is not dealing at arm's length with a particular entity which is not dealing at arm's length with the grantor will not be precluded from claiming the deduction under paragraph 110(1)(*d*) because of that relationship, so long as the particular entity is neither the employee's employer nor the entity whose securities can be acquired under the option.

Second, the arm's length test is amended so that, where there has been an exchange of options under subsection 7(1.4), the test is applied with respect to the original option and not with respect to any subsequent exchange of options.

The amendments to the arm's length test correct recent legislative changes that, inadvertently, had a tightening effect (extending the test to all persons not dealing at arm's length with the grantor) and a relieving effect (ceasing to apply the test to the original option after an exchange). They also further relax the test by restricting its

application to the original option when there has been an exchange of options.

The amendments to paragraph 110(1)(*d*) apply to the 1998 and subsequent taxation years.

Charitable Donation of Employee Option Securities

ITA
110(1)(*d*.01)

New paragraph 110(1)(*d*.01) of the Act allows an employee to deduct a portion of the employment benefit that the employee is deemed by subsection 7(1) of the Act to have received in connection with the acquisition of a security under an employee option agreement, if the employee donates the security to a qualified donee (other than a private foundation). For this purpose, a "security" (as defined in subsection 7(7) of the Act) means a share of the capital stock of a corporation or a unit of a mutual fund trust. A "qualified donee" (as defined in subsections 149.1(1) and 248(1) of the Act) means, in general terms, a person to whom gifts may be made that qualify for the charitable donations deduction or tax credit.

In order to qualify for a deduction under new paragraph 110(1)(*d*.01), the employee must also be eligible for the regular employee option deduction under paragraph 110(1)(*d*). (In general terms, this means that (i) the employee was dealing at arm's length, when the option was granted, with the employer, the grantor of the option and the person whose security was acquired under the option, (ii) the option was not issued at a discount and (iii) the security, if it is a share, is an ordinary common share.) The combined effect of the two deductions is to tax the employment benefit on the donated security at a rate that is comparable to the reduced capital gains inclusion rate provided under paragraph 38(*a*.1) of the Act for securities donated to a charity.

The additional deduction under paragraph 110(1)(*d*.01) is available for donated securities acquired after February 27, 2000 and before 2002. In order to qualify for the deduction, the donation must be made in the same year as the security was acquired and no later than 30 days after acquisition. If the security is a share, it must be of a

class of shares listed on a Canadian or foreign stock exchange described in section 3200 or 3201 of the *Income Tax Regulations*.

The amount of the deduction under new paragraph 110(1)(*d*.01) depends on the amount of the regular deduction under paragraph 110(1)(*d*). If the regular deduction is 1/3 of the employment benefit, the additional deduction is also 1/3, and the net result is that only 1/3 of the employment benefit is subject to tax. If the regular deduction is 1/2, the additional deduction is 1/4, and the net result is that only 1/4 of the employment benefit is subject to tax. Generally, the 1/3 rate applies to securities acquired after February 27, 2000 and before October 18, 2000, and the 1/4 rate applies to securities acquired after October 17, 2000.

It should be noted that if the security is worth less when it is donated than when it was acquired, the additional deduction under paragraph 110(1)(*d*.01) is based on the employment benefit that the employee would have been deemed by subsection 7(1) to have received if the value of the security at the time of acquisition were that lesser value.

It should also be noted that, if the employee owns other securities that are identical to the security acquired under the employee option agreement, new subsection 7(1.31) may apply to deem the option security as the security being donated. In these circumstances, new subsection 47(3) also applies to exempt the security from the cost-averaging rule in subsection 47(1). Consequently, the adjusted cost base of the donated security, and thus the capital gain or loss on the disposition of the security, is determined without regard to the adjusted cost base of any other securities acquired by the employee.

Finally, it should be noted that, by virtue of new subsection 110(2.1), the deduction under paragraph 110(1)(*d*.01) may also be available where an employee sells an employee option security and donates all or part of the proceeds of the disposition to a qualifying charity. To qualify, certain conditions must be met regarding the acquisition and disposition of the security, and the donation of the proceeds of disposition to charity. Furthermore, the deduction will be prorated to reflect the proportion of the proceeds that are donated.

Employee Options

ITA
110(1)(*d*.1)

Paragraph 110(1)(*d*.1) of the Act provides a deduction in computing the taxable income of a taxpayer where the taxpayer has included an amount in income for the year under paragraph 7(1)(*a*) of the Act in respect of a share acquired.

The paragraph is amended to replace the reference to the fraction "1/4" with a reference to the fraction "1/2", and is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies in respect of benefits which, as a result of transactions, events or circumstances that occur after February 27, 2000, are deemed by section 7 of the Act to have been received by a taxpayer except that, where the transaction, event or circumstances occurs after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" is to be read as a reference to the fraction "1/3". These modifications are required in order to reflect the capital gains/losses rate for the year.

Prospector's and Grubstaker's Shares

ITA
110(1)(*d*.2)

Paragraph 110(1)(*d*.2) of the Act provides a deduction in computing the taxable income of a taxpayer where the taxpayer has included an amount in income for the year under paragraph 35(1)(*d*) of the Act in respect of a share.

The paragraph is amended to replace the reference to the fraction "1/4" with a reference to the fraction "1/2", and is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2. The amendment applies with respect to dispositions and exchanges that occur after February 27, 2000 except that, for dispositions and exchanges that occur after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" is to be read as a reference to the fraction "1/3". These modifications are required in order to reflect the capital gains/losses rate for the year.

Employer's Shares

ITA
110(1)(*d*.3)

Paragraph 110(1)(*d*.3*)* of the Act provides a deduction in computing the taxable income of a taxpayer where the taxpayer has included an amount in income for the year under subsection 147(10.4) of the Act in respect of a disposition of shares. Subsection 147(10.4) deals with the disposition of employer shares that had previously been received as part of a single payment from a deferred profit sharing plan.

The paragraph is amended to replace the reference to the fraction "1/4" with a reference to the fraction "1/2", and is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies in respect to dispositions and exchanges that occur after February 27, 2000 except that, for dispositions and exchanges that occur after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" is to be read as a reference to the fraction "1/3". This modification is required in order to reflect the inclusion rate for capital gains realized during that period.

Determination of Amounts Relating to Employee Security Options

ITA
110(1.5)

Subsection 110(1.5) of the Act contains a special rule that is relevant for purposes of determining eligibility for the deduction under paragraph 110(1)(*d*) in respect of certain stock option benefits.

Specifically, subsection 110(1.5) requires that, for the purposes of subparagraph 110(1)(*d*)(iii), certain changes in share structure that occur after a stock option is granted be considered in determining the fair market value of the shares at the time the option was granted. For example, where there is a one-for-two consolidation of stock option shares after the options are granted but before they are exercised, the fair market value of the shares at the time the options were granted would, for purposes of subparagraph 110(1)(*d*)(iii), be considered to be twice the actual value of the shares at that time.

Subsection 110(1.5) is amended in a number of ways.

First, it is amended so that it applies for all purposes of paragraph 110(1)(*d*), not just for the purposes of subparagraph 110(1)(*d*)(iii).

Second, it is amended so that it applies to units of a mutual fund trust as well as to shares of the capital stock of a corporation.

Third, it is amended to replace the detailed description of the specific structural changes that are to be taken into account in determining a security's fair market value with a simple reference to "specified events" (as defined in new subsection 110(1.6) of the Act).

Fourth, it is amended to provide that, in determining the opening exercise price of an option that has been received in exchange for another option under circumstances to which subsection 7(1.4) of the Act applies, all "specified events" (as defined in subsection 110(1.6)) that occur after the option is granted are to be taken into account. This is relevant in determining if the condition in clause 110(1)(*d*)(iii)(A) or (D), as the case may be, is satisfied when the new option is subsequently exercised or disposed of or exchanged for another option in accordance with subsection 7(1.4). This provision is set out in new paragraph 110(1.5)(*c*).

Finally, it is amended to provide for the exercise price under an employee option agreement to be determined without reference to changes in the value of a foreign currency relative to Canadian currency after the option is granted. This is currently provided for in paragraph 110(1)(*d*), but is being moved to amended paragraph 110(1.5)(*a*).

These changes, which apply to the 1998 and subsequent taxation years, are consequential on changes to paragraph 110(1)(*d*) (including changes previously made in the 1998 budget bill [S.C. 1999, c.22 (formerly Bill C-72)] to extend the application of that paragraph to mutual fund trust units and to improve its readability).

Meaning of "Specified Event"

ITA
110(1.6)

New subsection 110(1.6) of the Act defines "specified event", which is relevant for amended subsection 110(1.5) of the Act. That subsection requires that, in determining either the fair market value of an employee option security at the time the option was granted or the opening exercise price to acquire a security under an option received in exchange for another option in accordance with subsection 7(1.4) of the Act, all specified events associated with the security that occurred after the option was granted are to be taken into account. For this purpose, a security is defined by subsection 7(7) of the Act to be a share of the capital stock of a corporation or a unit of a mutual fund trust.

Paragraph 110(1.6)(*a*) describes the events that are considered to be specified events associated with a share of the capital stock of a corporation. The events, which were previously set out in subsection 110(1.5), include a split or consolidation of shares of the corporation, a reorganization of share capital of the corporation and a stock dividend.

Paragraph 110(1.6)(*b*) describes the events that are considered to be specified events associated with a unit of a mutual fund trust. The events, which are comparable to those identified for shares, include a split or consolidation of trust units and the issuance of new units out of the income or capital of the trust. The recognition of such events in the context of a mutual fund trust is consequential on changes previously made to section 7 and paragraph 110(1)(*d*) of the Act to extend the stock option rules to mutual fund trust units.

New subsection 110(1.6) applies to the 1998 and subsection taxation years.

Definitions in Subsection 7(7)

ITA
110(1.7)

New subsection 110(1.7) of the Act provides that the definitions "security" and "qualifying person" in subsection 7(7) of the Act apply for the purposes of amended subsection 110(1.5) and new subsection 110(1.6).

Charitable Donation – Proceeds of Disposition of Employee Option Securities

ITA
110(2.1)

New subsection 110(2.1) of the Act allows an employee to claim a deduction under new paragraph 110(1)(*d*.01) where the employee, in exercising an option to acquire a security, directs the person administering the employee security option plan for the employer to sell the security immediately and donate all or part of the proceeds of the disposition to a qualifying charity. The deduction is equal to the amount that would have been deductible under new paragraph 110(1)(*d*.01) if the security had been so donated, prorated to reflect the proportion of the proceeds that are donated. This deduction applies to securities acquired after February 27, 2000.

Example

In August 2001, Julie exercises options to acquire 100 shares of her corporate employer. The exercise price is $10 a share and the fair market value at the time of acquisition is $110 a share. At her direction, the administrator of the stock option plan for the employer immediately sells all of the shares for proceeds of disposition equal to $11,000, pays $1,000 to the employer to cover the exercise price and pays the remaining $10,000 to a designated charity.

Subsection 7(1) deems Julie to have received a benefit equal to $10,000 (i.e., the fair market value of the shares at the time of acquisition less the exercise price). Julie is entitled to a deduction of $5,000 under paragraph 110(1)(d) (= 1/2 of $10,000). If she

had donated the shares to a charity, she would have been entitled to an additional deduction of $2,500 under paragraph 110(1)(d.01) (= 1/4 of $10,000). Since she donated 90% of the proceeds from the disposition of the shares, she is entitled to deduct $2,250 under paragraph 110(1)(d.01) (= 90% of $2,500).

Clause 52

Charitable Donations Deduction

ITA
110.1

Section 110.1 of the Act provides for the deductibility in computing income of charitable donations and certain other gifts.

Ecological gifts

ITA
110.1(1)(*d*)

Subsection 110.1(1) of the Act provides a deduction in computing taxable income in respect of gifts made by corporations to registered charities and to certain other entities. Paragraph 110.1(1)(*d*) provides an exemption from the annual 75% income limit for gifts of land (including a covenant, an easement or a servitude in respect of land) that is certified by the Minister of the Environment to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister, important to the preservation of Canada's environmental heritage. The beneficiary must be the federal government, a provincial or territorial government, a municipality or a registered charity approved by the Minister of the Environment.

Paragraph 110.1(1)(*d*) is amended to require that the fair market value of the gift be certified by the Minister of the Environment. The fair market value is relevant to the calculation of the deduction available to the corporation under paragraph 110.1(1)(*d*) and of the taxable capital gain under section 38 of the Act.

This amendment applies to gifts made after February 27, 2000.

Proof of Gift

ITA
110.1(2)

Subsection 110.1(2) of the Act provides that no deduction may be made in respect of a charitable donation or a gift to the Crown unless the gift is evidenced by a receipt containing prescribed information. The subsection is amended to clarify that, in the case of a gift of certified cultural property or an ecological gift, certificates issued by the Cultural Property Export Review Board or the Minister of the Environment must also be submitted.

This amendment applies to gifts made after February 27, 2000, except that the amendment in respect of cultural property does not apply to gifts made before Announcement Date.

Ecological gifts

ITA
110.1(5)

Subsection 110.1(5) of the Act provides that the fair market value of a corporation's gift of a covenant, easement or servitude in respect of ecologically sensitive land will not be considered to be less than the decrease in value of the subject land that resulted from the making of the gift. That amount is also, subject to the designation of an amount under subsection 110.1(3) of the Act, the corporate donor's proceeds of disposition for the purposes of calculating income and capital gains.

Subsection 110.1(5) is amended concurrently with paragraph 110.1(1)(*d*) of the Act, to provide that the fair market value of ecologically sensitive land (including a covenant, an easement or a servitude) and, consequentially, the corporate donor's proceeds of disposition, is deemed to be the amount determined by the Minister of the Environment.

Administrative measures regarding the request for a determination of fair market value from the Minister of the Environment, including notification, determination and redetermination, are included in new subsections 118.1(10.2) to (10.5) of the Act. Consequential

assessments of tax are provided for in amended subsection 118.1(11) of the Act. Appeals to the Tax Court of Canada are provided for in new subsection 169(1.1) of the Act.

This amendment applies to gifts made after February 27, 2000.

Clause 53

Lifetime Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act sets out the rules that apply in calculating an individual's entitlement to the lifetime capital gains exemption.

ITA
110.6(1)

"investment expense"

Section 110.6 of the Act sets out the rules for calculating an individual's entitlement to the lifetime capital gains exemption. An individual's "investment expense" for a taxation year can result in a lower "cumulative gains limit", and can thereby reduce the individual's entitlement to a deduction under section 110.6. As a consequence of the application of subparagraph (*a*)(ii) and paragraph (*d*) of the definition "investment expense" in subsection 110.6(1), 50% of foreign exploration and development expenses deducted under subsection 66(4) in computing an individual's income for a taxation year is added in computing the individual's investment expense for the year in the event that the individual is a "specified member" of the partnership (as defined in subsection 248(1)).

Subparagraph (*a*)(ii) and paragraph (*d*) of the definition "investment expense" are amended to extend this treatment of foreign exploration and development expenses to foreign resource expenses, as a consequence of the introduction of section 66.21.

These amendments apply to taxation years that begin after 2000.

Capital Gains Deduction – Qualified Farm Property

ITA
110.6(2)

Subsection 110.6(2) of the Act provides a deduction from income in computing the taxable income of taxpayer in respect of taxable capital gains from the disposition of qualified farm property.

Paragraph 110.6(2)(*a*) determines the unused portion of an individual's lifetime capital gains exemption limit in respect of capital gains realized on dispositions of qualified farm property. The paragraph is amended as a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2, and applies to taxation years that end after February 27, 2000.

Amended subsection 110.6(2)(*a*)

- decreases the lifetime taxable capital gains exemption limit from $375,000 to $250,000 to reflect the reduction of the inclusion rate for capital gains from 3/4 to 1/2,

- reduces the limit by the deductions claimed in prior years that ended before 1988, when the taxable capital gains inclusion rate was 1/2,

- reduces the limit by 3/4 of the deductions claimed in prior years that ended after 1987 and before 1988, and for taxation years that began after February 27, 2000 and ended before October 18, 2000 when the inclusion rate for capital gains was 2/3,

- reduces the limit by 8/9 of the deductions claimed in taxation years that ended after 1989 and before February 27, 2000, when the inclusion rate for capital gains was 3/4,

- reduces the limit by 8/9 of the deductions claimed in taxation years that ended after 1987 and before 1990 in respect of amounts included in income under subparagraph 14(1)(*a*)(v) of the Act when the inclusion rate was 3/4, and

- reduces the limit by the product obtained by multiplying the deductions claimed by the individual in the 2000 taxation year by

the fraction obtained by multiplying 1/2 by the reciprocal of the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year.

These amendments apply in respect taxation years that end after February 27, 2000 except that, in computing an individual's taxable income for the taxation year that includes either February 28, 2000 or October 17, 2000, the amount determined by the formula in paragraph 110.6(2)(*a*) is to equal the amount determined under that formula multiplied by twice the fraction in amended paragraph 38(*a*) that applies to the taxpayer for that year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Example 1

<u>Assume</u>

Paul has in prior taxation years reported the following:

Taxation Year	**Capital Gain from the Disposition of Qualified Farm Property**	**Amount deducted under subsection 110.6(2)**
1985	$50,000	$25,000
1988	$100,000	$66,667
1991	$100,000	$75,000

No other amounts have been deducted by Paul under section 110.6.

In January, 2000, Paul realizes a $300,000 capital gain from the disposition of qualified farm property. The fraction required to be used by Paul under amended paragraph 38(a) for his 2000 taxation year is 3/4. What amount can be deducted by Paul under subsection 110.6(2) for his 2000 taxation year assuming paragraph 110.6(2)(a) applies?

<u>Determination</u>

Paragraph 110.6(2)(a) requires Paul to determine an amount using the formula $250,000-(A+B+C+D).

Because Paul's 2000 taxation year includes either February 28, 2000 or October 17, 2000, the coming-into-force provision that applies to amended paragraph 110.6(2)(a) requires Paul to multiply the amount determined by the formula by 1.5 (i.e., twice the fraction that applies for the year: 3/4 X 2).

The amount of the unused deduction limit determined by the formula equals $125,000 since

A = $25,000,
B = $50,000 (i.e., 3/4 66,667),
C = $50,000 (i.e., 2/3 x $75,000), and
D = $0

For the taxation year that includes either February 28, 2000 or October 17, 2000, the unused capital gains exemption limit determined under the formula ($125,000) is multiplied by 1.5 to produce an unused deduction limit of $187,500.

The $187,500 is the amount determined for Paul under paragraph 110.6(2)(a) for his 2000 taxation year.

Example 2

Heather realized a $400,000 capital gain in her 2000 taxation year from the disposition of qualified farm property and deducted $300,000 in respect of that gain under section 110.6. The fraction in paragraph 38(a) that was applicable to Heather for her 2000 taxation year was 3/4. In 2001, Heather realizes a $100,000 capital gain from the disposition of another qualified farm property. Heather has not realized any other capital gains. How much is she entitled to deduct under subsection 110.6(2) assuming paragraph 110.6(2)(a) applies?

<u>Determination</u>

Paragraph 110.6(2)(a) requires Heather to determine an amount using the formula $250,000-(A+B+C+D).

The amount determined by the formula equals $50,000 since

A = $0,
B = $0,
C = $0, and
D = $200,000 (4/3 x 1/2 x $300,000).

The deductions permitted under section 110.6 for Heather's 2000 and 2001 taxation years allow her to claim deductions in respect of taxable capital gains derived from $500,000 of capital gains realized from the disposition of qualified farm property.

Capital Gains Deduction – Qualified Small business Corporation Shares

ITA
110.6(2.1)

Subsection 110.6(2.1) of the Act provides a deduction in computing the taxable income of taxpayer in respect of taxable capital gains from the disposition of qualified small business corporation shares.

Paragraph 110.6(2.1)(*a*) is amended as a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2, and applies to taxation years that end after February 27, 2000. Amended subsection 110.6(2.1)(*a*) refers to the amount referred to in proposed new paragraph 110.6(2)(*a*).

Maximum Capital Gains Deduction

ITA
110.6(4)

Subsection 110.6(4) of the Act provides an overall lifetime taxable capital gains exemption limit for an individual.

The subsection is amended to adopt the limit provided for in paragraph 110.6(2)(*a*). Under that paragraph, the individual is limited to $250,000 of deductions in respect of taxable capital gains – which is determined by multiplying $500,000 of capital gains by the one-half inclusion rate for capital gains.

The amendment to subsection 110.6(4) is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2. It is effective for taxation years that end after February 27, 2000.

Spousal or Common-Law Partner Trust Deduction

ITA
110.6(12)

Subsection 110.6(12) of the Act generally provides for a deduction, in computing the taxable income of a trust for the benefit of a spouse or common-law partner for the year of the trust in which the spouse or common-law partner dies, of an amount equal to the lesser of the unused lifetime capital gains exemption limit of the deceased and the amount of the taxable gains of the trust determined under that subsection.

Paragraph 110.6(12)(*c*) is amended to adopt the limit provided for in paragraph 110.6(2)(*a*) in respect of the deceased spouse or common-law partner for the year of death, minus any amounts deducted by that person for the year of death.

The amendment to paragraph 110.6(12)(*c*) is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000, except that the amount determined under amended paragraph 110.6(12)(*c*) in computing a trust's taxable income for a taxation year that includes either February 28, 2000 or October 17, 2000 is to equal the amount determined under that paragraph multiplied by the quotient obtained when the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer's spouse or common-law partner for the taxation year in which the spouse or common-law partner died is divided by the fraction in amended paragraph 38(*a*) that applies to the trust for its taxation year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 54

Loss Carryovers

ITA
111

Section 111 of the Act establishes the extent to which a taxpayer is permitted to deduct, in computing taxable income for a taxation year, losses of other years.

Carryforward of Limited Partnership Losses

ITA
111(1)(*e*)(ii)(C)(I)

To the extent provided by paragraph 111(1)(*e*), limited partnership losses (as defined in subsection 96(2.1)) for a taxation year in respect of a partnership may be carried forward for deduction in computing taxable income for a subsequent taxation year. The potential deduction in respect of a partnership is reduced to reflect the amount by which the taxpayer's "at-risk amount" in respect of the partnership exceeds the taxpayer's shares of specified resource expenditures (including foreign exploration and development expenses) incurred by the partnership.

Subclause 111(1)(*e*)(ii)(C)(I) is amended so that "foreign resource pool expenses", as newly defined in subsection 248(1), are referred to instead of foreign exploration and development expenses. The new definition includes expenses that are a foreign resource expense, as defined in new section 66.21, in addition to foreign exploration and development expenses.

This amendment applies to taxation years that begin after 2000.

Definitions

ITA
111(8)

"non-capital loss"

The description of E in the definition "non-capital loss" lists certain amounts to be included in determining the amount of the loss to ensure that the loss is not understated.

The description of E is amended so that amounts deducted by a taxpayer under new paragraph 110(1)(*d*.01) are included in determining the taxpayer's non-capital loss. Paragraph 110(1)(*d*.01) allows a deduction where certain employee option securities (or proceeds from the disposition of such securities) are donated to a qualifying charity.

This amendment applies to the 2000 and subsequent taxation years.

"pre-1986 capital loss balance"

An individual's "pre-1986 capital loss balance" for a taxation year is relevant for the purposes of paragraph 111(1.1)(*b*) of the Act and represents the individual's unused pre-1986 capital losses that the individual can deduct, up to $2000 per year, from income other than capital gains of the individual.

The definition is amended as a consequence of the reduction of the inclusion rate for capital gains, applicable to taxation years that end after February 27, 2000.

Under the current definition, because of the description of D in the formula, pre-1986 capital losses are reduced by 3/4 of the deductions claimed under section 110.6 of the Act for taxation years that ended after 1987 and before 1990. This description reflects the fact that the inclusion rate for those years was 2/3 rather than the 1/2-rate used for years prior to 1986 when the pre-1986 net capital losses were accumulated. The description of D in the formula is amended to provide for the deduction from the pre-1986 net capital losses of 3/4 of the section 110.6 deductions claimed by the individual in respect of taxable capital gains realized in taxation years that ended after

1987 and before 1990 or began after February 27, 2000 and ended before October 18, 2000, when the inclusion rate for capital gains was 2/3 rather than the 1/2 used for years prior to 1986 when the pre-1986 net capital losses were accumulated.

The description of E in the formula is amended to provide for the deduction from the pre-1986 net capital losses of 2/3 of the section 110.6 deductions claimed by the individual in respect of taxable capital gains realized in taxation years that ended after 1989 and before February 28, 2000, when the inclusion rate for capital gains was 3/4 rather than the 1/2 used for years prior to 1986 when the pre-1986 net capital losses were accumulated.

The description of E.1 in the formula provides for the deduction from the pre-1986 net capital losses of amounts in respect of deductions claimed under section 110.6 in the 2000 taxation year of the individual that includes either February 28, 2000 or October 17, 2000. The deduction is the product obtained by multiplying the total amounts of the individual's deductions claimed for the year by the fraction obtained by dividing 1/2 by the fraction in paragraph 38(*a*) that applies to the individual for the year.

These amendments apply to taxation years that end after February 27, 2000.

Clause 55

Loss on Share Held by Trust

ITA
112(3.2) and (3.3)

Subsections 112(3.2) and (3.3) of the Act provide rules for the determination of a loss of a trust from a disposition of a share where the trust has received taxable dividends and capital dividends on the share.

The amendments to these subsections, which apply to dispositions that occur after February 27, 2000, replace the reference to the fraction "1/4" with a reference to the fraction "1/2" and are

consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

Clause 56

Non-resident's Taxable Income in Canada

ITA
115

Section 115 of the Act determines the amount of a non-resident person's income that is subject to tax under Part I of the Act. This amount is referred to as the non-resident's "taxable income earned in Canada". Subsection 115(1) provides the general rules for the calculation of this amount, including deductions provided under paragraphs 115(1)(*d*) to (*f*).

ITA
115(1)(*d*)

Subsection 115(1) of the Act sets out the general rules for determining the amount of a non-resident person's income that is subject to tax under Part I of the Act. Paragraph 115(1)(*d*) allows certain deductions under subsections 110(1), 110.1(1) and 111(1) of the Act to be taken into account in determining this amount.

Paragraph 115(1)(*d*) is amended to allow a deduction under new paragraph 110(1)(*d*.01) to be taken into account. Paragraph 110(1)(*d*.01) allows a deduction where certain employee option securities (or proceeds from the disposition of such securities) are donated to a qualifying charity. The deduction may be taken into account to the extent that the securities option benefit to which the deduction relates is included in computing the amount of the non-resident person's income that is subject to tax under Part I of the Act.

This amendment applies to the 2000 and subsequent taxation years.

ITA
115(1)(*e*.1) and (4.1)

Paragraph 115(1)(*e*.1) of the Act is introduced to allow the deduction provided under subsection 115(4.1) in computing a non-resident's taxable income earned in Canada.

Notwithstanding that a non-resident taxpayer is precluded under subsections 66(4) and 66.21(4) of the Act from claiming deductions for foreign exploration and development expenses (FEDE) and foreign resource expenses (FRE) in computing income, new subsection 115(4.1) permits a non-resident taxpayer (who ceased to be resident in Canada after February 27, 2000) to claim a deduction in computing taxable income earned in Canada with reference to the rules in those subsections. The amount so claimed by a taxpayer is based on the taxpayer's unused FEDE and FRE balances immediately after ceasing to reside in Canada. The claim for the first taxation year of non-residence cannot exceed 10% of that balance, and does not depend on the level of related foreign resource income. The 10% limit also applies to subsequent taxation years, but is determined with reference to those balances (computed net of relevant deductions previously claimed under subsection 115(4.1)).

These amendments apply to taxation years that begin after February 27, 2000.

Clause 57

Disposition of Property by Non-Resident

ITA
116(2), (4) and (5)

Section 116 of the Act provides for the issuance of a certificate for non-residents disposing of taxable Canadian property. In order to receive the certificate, an amount equal to 33 1/3% of the anticipated gain must be paid by the non-resident on account of income taxes that may become payable as a result of the disposition. This amount is based on the tax rate and the capital gains inclusion rate.

These subsections are amended to replace the reference to the percentage "33 1/3%" with a reference to the percentage "25 %", consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

These amendments apply to taxation years that end after February 27, 2000 except that for a taxation year that ends after February 27, 2000 and before October 18, 2000, the reference to the percentage "25%" is to be read as reference to the percentage "30%". These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 58

Tax Rates for Individuals

ITA
117

Section 117 of the Act sets out the tax rates for individuals.

ITA
117(2)

Subsection 117(2) of the Act provides the marginal tax rates of federal tax. These amendments provide two tax rate structures: one for 2000 and the other for the 2001 and subsequent taxation years.

The 2000 tax structure is as follows:

- 17 per cent of taxable income up to $30,004
- 25 per cent of taxable income between $30,004 and $60,009
- 29 per cent of taxable income that exceeds $60,009.

The tax structure for 2001 and subsequent years is as follows:

- 16 per cent of taxable income up to $30,754
- 22 per cent of taxable income between $30,754 and $61,509
- 26 per cent of taxable income between $61,509 and $100,000
- 29 per cent of taxable income that exceeds $100,000.

ITA
117(3)

New subsection 117(3) of the Act provides that the income thresholds of $30,754, $61,509 and $100,000 used in computing an individual's tax for the 2004 taxation year will not be less than $35,000, $70,000 and $113,804, respectively, regardless of the annual increase provided under the indexing provisions of the Act.

This amendment applies to the 2004 taxation year.

Clause 59

Personal Tax Credits

ITA
118

Section 118 of the Act provides for the calculation of various personal tax credits.

ITA
118(1)B(*c*.1) and (*d*)

Paragraph (*c*.1) of the description of B in subsection 118(1) of the Act provides a tax credit to an individual who provides in-home care for an adult relative, while paragraph (*d*) of that description provides a tax credit to an individual who supports an infirm dependent relative. These amendments increase the amounts on which each credit is computed to $3,500 from $2,446.

These amendments apply to the 2001 and subsequent taxation years.

Minimum Amounts for 2004

ITA
118(3.1)

New subsection 118(3.1) of the Act provides that the amounts of $7,131, $6,055 and $606, which are used in computing an individual's basic tax credit and the tax credit that may be claimed by

the individual, in respect of a spouse, a common-law partner or, in some circumstances, a wholly dependent person will not, for the 2004 taxation year, be less than $8,000, $6,800 and $680, respectively, regardless of the annual increase provided under the indexing provisions of the Act.

This amendment applies to the 2004 taxation year.

Clause 60

Charitable Donations Tax Credit

ITA
118.1

Section 118.1 of the Act provides for a charitable donations tax credit that may be claimed by individuals who make charitable donations, gifts to the Crown and certain gifts of cultural property and ecologically sensitive land. Donors may carry forward unused claims for up to five years.

Definitions

ITA
118.1(1)

"total ecological gifts"

Subsection 118.1(3) of the Act provides for a tax credit in respect of gifts made by individuals to registered charities and certain other entities. Unlike most charitable gifts, the eligible value of qualified ecological gifts is not subject to an annual 75% income limit. An ecological gift is defined in subsection 118.1(1) as a gift of land (including a covenant, an easement or a servitude) that is certified by the Minister of the Environment to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister, important to the preservation of Canada's environmental heritage. The beneficiary must be the federal government, a provincial or territorial government, a municipality or a registered charity approved by the Minister of the Environment.

The definition "total ecological gifts" in subsection 118.1(1) is amended to require that the fair market value of the gift be certified by the Minister of the Environment. The fair market value is relevant to the calculation of the tax credit available to the individual under paragraph 110.1(1)(*d*) and of the taxable capital gain under section 38.

This amendment applies to gifts made after February 27, 2000.

Proof of Gift

ITA
118.1(2)

Subsection 118.1(2) of the Act provides that no deduction may be made in respect of a charitable donation or a gift to the Crown unless the gift is evidenced by a receipt containing prescribed information. The subsection is amended to clarify that, in the case of a gift of cultural property or an ecological gift, certificates issued by the Cultural Property Export Review Board or the Minister of the Environment must also be submitted.

This amendment applies to gifts made after February 27, 2000, except that the amendment in respect of cultural property does not apply to gifts made before Announcement Date.

Gift in Year of death

ITA
118.1(4)

Subsection 118.1(4) of the Act provides a special rule in the case of gifts that are made by an individual in the taxation year in which the individual dies. Under that subsection, a gift made by the individual in that year is generally considered to have been made in the individual's preceding taxation year, to the extent that the charitable donations tax credit in respect of the amount of the gift is not deducted in computing the individual's tax for the year of death. The gifts of a deceased individual to which subsection 118.1(4) applies include those otherwise deemed by specified provisions in section 118.1 to be gifts made immediately before the individual died.

Subsection 118.1(4) is amended so that new subsections 118.1(5.2) and (5.3) are included among the specified provisions. These subsections deal with cases where a charity is a beneficiary under a life insurance policy or under a trust governed by a registered retirement savings plan or registered retirement income fund. As a consequence of the amendment to subsection 118.1(4), gifts deemed by subsection 118.1(5.2) or (5.3) to have been made by an individual immediately before the individual's death can result in a reduction in the individual's tax for the taxation year preceding the taxation year of the individual's death.

This amendment applies to deaths that occur after 1998.

Direct Designation – Insurance Proceeds

ITA
118.1(5.1) and (5.2)

New subsection 118.1(5.2) of the Act, in conjunction with new subsection 118.1(5.1), extends the charitable donations tax credit to transfers under a life insurance policy that are made as a consequence of designations under the policy. As a result, the charitable donations tax credit can be claimed on an individual's death as a consequence of qualifying transfers to qualified donees under life insurance policies that insure the individual's life. Each of the conditions set out in paragraphs 118.1(5.1)(*a*) to (*d*) must be satisfied for this result to apply.

Paragraph 118.1(5.1)(*a*) requires the policy to be a life insurance policy in Canada (as defined by subsection 138(12)) under which, immediately before the individual's death, the individual's life was insured. The policy could include a group life insurance policy, an annuity or a segregated fund policy.

Paragraph 118.1(5.1)(*b*) requires that, as a consequence of the individual's death, a transfer of money (or a transfer by means of a negotiable instrument) to a qualified donee (which is being defined in subsection 248(1) with reference to the existing definition in subsection 149.1(1)) be made from an insurer, solely because of the insurer's obligations under the policy. The transfer might be provided for in the individual's will or in a non-testamentary written designation made by the individual.

Paragraph 118.1(5.1)(*c*) requires that, immediately before the individual's death, the donee was neither a policyholder under the policy nor an assignee of the individual's interest under the policy. The conditions in paragraph 118.1(5.1)(*c*) are not satisfied, for example, where an individual takes out a life insurance policy and makes an absolute assignment of the policy to a qualified donee. In the latter case, the CCRA has interpreted this provision to the effect that the individual would generally be considered to have made a gift because of, and at the time of, the assignment. (See Interpretation Bulletin IT-244R3.)

Paragraph 118.1(5.1)(*c*) also requires that, immediately before the individual's death, the individual was a person whose consent was required to change the recipient of the transfer. Normally, this would mean that the individual must, immediately before death, have been the policyholder. However, in the context of group policies, the individual might instead have rights (immediately before death) in respect of the policy that could be enforced against the policyholder (e.g., the individual's employer or former employer).

Paragraph 118.1(5.1)(*d*) requires that the transfer occur not more than 36 months after the individual's death, or within such longer period as the Minister of National Revenue considers reasonable.

Where the conditions set out in paragraphs 118.1(5.1)(*a*) to (*d*) are satisfied in connection with a transfer under an insurance policy as a consequence of the death of an individual:

- the transfer is deemed to be a gift made by the individual immediately before the individual's death (paragraph 118.1(5.2)(*a*)); and

- the fair market value of that gift is deemed to be the fair market value, at the time of the individual's death, of the right to the transfer (paragraph 118.1(5.2))(*b*)). This fair market value is determined without reference to any risk of default with regard to the insurer's obligations. In nearly all cases, this is expected to be the fair market value, at the time of the individual's death, of the money (or of the proceeds of the negotiable instrument) ultimately transferred.

New subsections 118.1(5.1) and (5.2) apply to deaths that occur after 1998.

Direct Designation – RRSPs and RRIFs

ITA
118.1(5.3)

New subsection 118.1(5.3) of the Act extends the charitable donations tax credit to a transfer of money (or a transfer by means of a negotiable instrument) from a trust governed by a registered retirement savings plan (RRSP) or registered retirement income fund (RRIF), where the transfer is made as a consequence of a qualified donee being named a beneficiary under the trust. As a result, the charitable donations tax credit can be claimed on an individual's death as a consequence of transfers to qualified donees from such a trust if the individual was the annuitant under the plan or fund that governed the trust. For this result to apply, the transfer must be made not more than 36 months after the individual's death, or within such longer period as the Minister of National Revenue considers reasonable.

Refer to the commentary on subsection 248(1) for a discussion of the definition "qualified donee".

Where subsection 118.1(5.3) applies in connection with a transfer from an RRSP or RRIF trust under which an individual was the annuitant:

- the transfer of the property is deemed to be a gift made by the individual immediately before the individual's death (paragraph 118.1(5.3)(*a*)); and

- the fair market value of that gift is deemed to be the fair market value, at the time of the individual's death, of the right to the transfer, which fair market value is determined without reference to any risk of default with regard to the trust's obligations, (paragraph 118.1(5.3)(*b*)).

This amendment applies to deaths that occur after 1998.

Determination of Fair Market Value

ITA
118.1(10.1)

Subsection 118.1(10.1) of the Act applies, for the purposes of section 118.1 (donations and gifts by individuals) and section 110.1 of the Act (donations and gifts by corporations), where the Cultural Property Export Review Board has determined or redetermined the fair market value of a property. If the property is the subject of a gift that is made within two years after the Board's valuation, and is claimed as a charitable donation that is not a gift of cultural property, the Board's valuation is deemed to be determinative of the fair market value of the property for the purposes of sections 110.1 and 118.1. An amount equal to that value is also deemed to be the proceeds of disposition of the property, subject to elective provisions in subsections 110.1(3), 118.1(6) and (7).

Subsection 118.1(10.1) is amended to extend its application to determinations and redeterminations of value made by the Minister of the Environment under new subsections 118.1(10.3) and (10.4).

Determination, Redetermination and Certification

ITA
118.1(10.2) to (10.5)

New subsections 118.1(10.2) to (10.5) of the Act are added to provide administrative procedures regarding the request for a determination of fair market value from the Minister of the Environment, including notification, determination and redetermination. (Appeals to the Tax Court of Canada are provided for in new subsection 169(1.1) of the Act.) These amendments are concurrent with the amendment of paragraph 110.1(1)(*d*), "ecological gifts", and the definition "total ecological gifts" in subsection 118.1(1), which require that the fair market value of ecologically sensitive land (including a covenant, an easement or a servitude) be certified by the Minister of the Environment.

New subsection 118.1(10.2) of the Act provides that, where a person disposes of, or proposes to dispose of, a property that, with the appropriate certification by the Minister of the Environment, would

qualify as an ecological gift, the person may request in writing that Minister make a determination of the fair market value of the property. New subsection 118.1(10.3) provides that, where a person makes such a request before the end of the third taxation year of the person following the year in which the property was disposed of, the Minister of the Environment will notify the person of the determination made.

New subsection 118.1(10.4) of the Act provides for the opportunity to request, within 90 days of notification of the determination of fair market value of a property by the Minister of the Environment, a redetermination of that fair market value. That Minister may also take the initiative to redetermine the fair market value at any time, even where no request has been made. In either case, that Minister will issue a notice of redetermination, and the redetermined fair market value is deemed to replace any previous amount determined or redetermined.

It is not necessary for a gift to have been made in order for a determination or redetermination to be made in respect of a person's property, so long as the person has proposed to make a gift of the property. However, no tax credit will be available until the gift is made.

Where a person has made the gift, the fair market value of which has been determined or redetermined by the Minister of the Environment, to the federal government, a provincial or territorial government, a municipality or a registered charity approved by that Minister, the Minister of the Environment will issue a certificate that states the fair market value determined or redetermined by that Minister. Where more than one certificate has been issued (because of a redetermination of fair market value), the last such certificate is deemed to replace any preceding certificate.

These amendments apply to gifts made, or proposed to be made, after February 27, 2000.

Assessments

ITA
118.1(11)

Subsection 118.1(11) of the Act provides that an assessment of tax can be made at any time in order to give effect to a certificate issued by the Cultural Property Export Review Board or to a court decision which varies a determination of the Board. Subsection 165(1.2) of the Act provides that no objection may be made to an assessment made under subsection 118.1(11).

Subsection 118.1(11) is amended to extend its application, in respect of ecologically sensitive land, to an assessment of tax resulting from a certificate of fair market value issued by the Minister of the Environment or a decision of a court in respect of an appeal of a redetermination of that Minister under new subsection 169(1.1) of the Act. Subsection 165(1.2) continues to apply to deny the right to object to an assessment made under subsection 118.1(11). A person's right of review of a determination of fair market value by the Minister of the Environment is provided instead by new subsections 118.1(10.4) and 169(1.1).

This amendment applies to gifts made after February 27, 2000.

Ecological Gifts

ITA
118.1(12)

Subsection 118.1(12) of the Act provides that the fair market value of a gift by an individual of a covenant, easement or servitude in respect of ecologically sensitive land will not be considered to be less than the decrease in value of the subject land that resulted from the making of the gift. That amount is also, subject to the designation of an amount under subsection 118.1(6), the individual's proceeds of disposition for the purposes of calculating income and capital gains.

Subsection 118.1(12) is amended concurrently with the definition of "total ecological gifts" in subsection 118.1(1), to provide that the fair market value of ecologically sensitive land (including a covenant, an easement or a servitude) and, consequentially, the individual's

proceeds of disposition, is deemed to be the amount determined by the Minister of the Environment to be its fair market value.

This amendment applies to gifts made after February 27, 2000.

Clause 61

Medical Expenses

ITA
118.2(2)(*l*.21)

Subsection 118.2(2) of the Act contains a list of expenditures which qualify as medical expenses. New paragraph 118.2(2)(*l*.21) adds to this list reasonable expenses, relating to the construction of the principal place of residence of an individual who lacks normal physical development or has a severe and prolonged mobility impairment, that can reasonably be considered to be incremental costs incurred to enable the individual to gain access to, or to be mobile or functional within, the individual's principal place of residence. As for all medical expenses, the portion of the expenses which is reimbursed (through special financial assistance, sales tax rebate or otherwise) does not qualify for the medical expenses tax credit, except to the extent that the reimbursement is required to be included in income and is not otherwise deductible in computing taxable income.

This amendment applies to the 2000 and subsequent taxation years.

Clause 62

Disability Tax Credit

ITA
118.3

Section 118.3 of the Act provides a tax credit for individuals who have a severe and prolonged mental or physical impairment.

Credit for Mental or Physical Impairment

ITA
118.3(1)

To be eligible for the disability tax credit (DTC) provided under section 118.3 of the Act, an individual must be markedly restricted in the activities of daily living. Even with the use of appropriate devices, medication or therapy, an individual must be either blind or generally unable to perform certain fundamental functions to qualify for the credit.

The preamble of the French version of subsection 118.3(1) of the Act is amended in light of the increase of the DTC (which is discussed below). Paragraphs 118.3(1)(*a*.1) and (*a*.2) are amended to extend eligibility for the DTC to individuals who would be so markedly restricted but for therapy administered to them at least three times each week for a total duration averaging not less than 14 hours a week in order to sustain one of their vital functions. Examples of taxpayers who will benefit from this extension include individuals with severe kidney disease requiring dialysis and persons with severe cystic fibrosis requiring clapping therapy in order to properly breathe.

These two amendments apply to the 2000 and subsequent taxation years.

Paragraph 118.3(1)(*a*.2) is further amended to authorize speech-language pathologists to certify a severe and prolonged speech impairment.

This amendment applies to certifications made after October 17, 2000.

Subsection 118.3(1) of the Act also provides the formula for calculating the DTC. Currently, under the formula, the amount of the credit is equal to 17% of $4,293. The amendment adds another component ("C") to the formula to provide, starting in 2000, a supplement amount of $2,941 for each disabled child under the age of 18 years at the end of the year. The supplement amount is reduced by the excess, over $2,000, of the total of child care and attendant care expenses paid in the year and claimed for income tax purposes in respect of the child. In 2001, the disability basic and supplement

amounts are, after indexing, increased to $6,000 and $3,500, respectively. The $2,000 care expense threshold for 2001 is increased, through indexing, to $2,050.

Disability Tax Credit Transfer

ITA
118.3(2)(*a*)(i)(B)

Subsection 118.3(2) of the Act provides criteria for determining the entitlement of a supporting individual of a disabled person to claim that person's unused disability tax credit. Currently, a supporting individual who is a parent, grandparent, child or grandchild of a disabled person may claim that person's unused disability tax credit (DTC) where a caregiver credit or an infirm dependant credit may be claimed by the individual in respect of the disabled person. The amendment extends the DTC transferability to other relatives of the disabled person who may claim the caregiver credit or the infirm dependant credit in respect of the disabled person. These include a supporting individual who is a brother, sister, aunt, uncle, nephew or niece of the disabled person, or of the spouse or common-law partner of the disabled person.

This amendment applies to the 2000 and subsequent taxation years.

Additional Information

ITA
118.3(4)

Subsection 118.3(4) of the Act gives to the Department of Human Resources Development (DHRD) the authority to request, from the disabled person, the supporting individual who claims (in whole or in part) the DTC in respect of the disabled person, or the certifying health professional, additional information to determine the disabled person's entitlement to the DTC. In recent years, the Canada Customs and Revenue Agency has developed its own "in-house" medical staff and, as a result, the advice of DHRD is no longer sought with respect to DTC claims. Accordingly, subsection 118.3(4) is amended to delete references to DHRD. The subsection is also modified as a consequence of the amendment to paragraph 118.3(1)(*a*.1) which extends the eligibility to the DTC to certain individuals who must

undergo extensive therapy subsection 118.3(1). For additional information about the amendment to that paragraph, see the commentary on subsection 118.3(1).

These amendments apply to the 2000 and subsequent taxation years.

Clause 63

Nature of Impairment – Reference to Medical Practitioner, etc.

ITA
118.4(2)

Subsection 118.4(2) of the Act provides a definition of the group of health professionals to whom various references in section 63 (relating to child care expenses), section 118.2 (relating to medical expenses), section 118.3 (relating to the disability tax credit) and section 118.6 (relating to the education tax credit) of the Act apply. This amendment is consequential on the amendment to paragraph 118.3 (1)(*a*.2) (see commentary on subsection 118.3(1)), which makes speech-language pathologists eligible to certify, after October 17, 2000, severe and prolonged speech impairments for the purpose of the disability tax credit.

This amendment applies to certifications made after October 17, 2000.

Clause 64

Education Tax Credit

ITA
118.6

Section 118.6 of the Act provides rules for determining the eligibility for the education tax credit.

ITA
118.6(1)

Subsection 118.6(1) of the Act provides the definition "designated educational institution" which is relevant for the purposes of the child care expense deduction and the tuition fee and education tax credits. Generally speaking, a designated educational institution is an institution providing post-secondary education, an educational institution certified by the Minister of Human Resources Development that furnishes or improves or improve skills in an occupation or a foreign university. The amendment to the preamble of that subsection is strictly consequential on the amendment to section 64 (see commentary on that section), which broadens the scope of the deduction of attendant care expenses to include such expenses incurred to attend a designated educational institution.

This amendment applies to the 2000 and subsequent taxation years.

ITA
118.6(2)(*a*) and (*b*)

Subsection 118.6(2) of the Act provides the formula for the calculation of the education tax credit. For 2000, this tax credie is determined by multiplying the "appropriate percentage" (17 per cent) by $200 ($60 in the case of part-time students) by the number of months in the year during which an individual is enroled in a qualifying program at a designated educational institution. This amendment doubles the monthly amounts for the 2001 and subsequent taxation years such that they will be set at $400 for full-time students and $120 for part-time students. Thus, for those years, the education tax credit will be computed by reference to those increased monthly amounts and the new lowest tax rate (16 per cent) applicable to individual.

This amendment applies to the 2001 and subsequent taxation years.

Clause 65

CPP/QPP Contribution and EI Premium Tax Credit

ITA
118.7

Section 118.7 of the Act provides the formula for calculating an individual's tax credit in respect of CPP/QPP contributions and employment insurance premiums. The amendment to paragraph (*c*) of the description of B of that formula is consequential on the introduction of paragraph 60(*e*) (see commentary on that paragraph). New paragraph 60(*e*) provides for the deduction, in computing an individual's income, of one-half of the CPP/QPP contributions payable on the individual's self-employed earnings, subject to one-half of the maximum of such contributions payable by the individual under the plan. The amendment ensures that the tax credit granted to the individual under section 118.7 in respect of CPP/QPP contributions of the individual's self-employed earnings is computed by reference to the other half of such contributions.

This amendment applies to the 2001 and subsequent taxation years.

Clause 66

Income Not Earned in a Province

ITA
120(1)

Subsection 120(1) of the Act provides for the payment by an individual of an additional tax of 52% of the federal tax otherwise payable in respect of the portion of the individual's income for the year that is not earned in a province. The additional tax has the effect of setting the individual's tax on income earned outside Canada at a level approximating that which would apply if provincial income tax were exigible (i.e., combined federal plus provincial tax).

The subsection is amended to reduce the rate of the additional tax to 48%, from 52%, for the 2000 and subsequent taxation years, in recognition of reductions to tax rates in the provinces.

Clause 67

Refundable Medical Expense Supplement

ITA
122.51(2)

Section 122.51 of the Act provides a refundable medical expense supplement. The supplement is equal to the lesser of $500 and 25/17 of the medical expense tax credit claimed by an eligible individual for the year. The supplement is reduced by 5% of the individual's "adjusted income" in excess of an indexed threshold ($17,664 for 2000).

Paragraph (*b*) of the description of A in subsection 122.51(2) is amended to replace the reference to "25/17" with a reference to "25/16", consequential on the reduction, from 17% to 16%, of the lowest tax rate applicable to individuals.

This amendment applies to the 2001 and subsequent taxation years.

Clause 68

Canada Child Tax Benefit

ITA
122.61(1)

Subsection 122.61(1) of the Act contains the calculation of the Canada Child Tax Benefit (CCTB). The CCTB is made up of two parts: a basic amount and a National Child Benefit (NCB) supplement. Unlike the basic amount, the amount of the NCB supplement payable to a family in respect of each qualified dependant varies depending on the number of qualified dependants in the family. Currently, the NCB supplement is $1,155 for the first qualified dependant, $955 for the second qualified dependant and $880 for each of the third and subsequent qualified dependants. Subsection 122.61(1) is amended to increase each of those three amounts by $100.

Currently, the CCTB is reduced by 5 per cent of family net income in excess of the lower income threshold for the second income tax bracket ($30,754 for 2001). These amendments increase this threshold to the greater of $32,000 and the indexed $30,754 income threshold.

These two amendments apply with respect to CCTB paid during months that are after June 2001.

As indicated above, the phase-out rate of the CCTB is currently set at 5 per cent (2 1/2 per cent for families with only one qualified dependant). These amendments reduce this rate to 4 per cent (2 per cent for families with only one qualified dependant) with respect to CCTB paid during months that are after June 2004.

Clause 69

Corporate Surtax

ITA
123.2

Section 123.2 of the Act levies a 4 % surtax on the tax payable under Part I of the Act by a corporation, other than a non-resident-owned investment corporation.

The surtax is calculated by reference to federal corporate tax payable after the 10-per-cent provincial abatement, but before tax credits such as the small business deduction and the manufacturing and processing deduction.

Paragraph 123.2(*a*) is amended to provide that the corporate surtax is to be based on the amount of federal income tax payable before taking into account any deduction under new section 123.4 as well. New section 123.4 of the Act provides a tax reduction to all corporations and an additional tax reduction to Canadian controlled private corporations.

The amendment applies to the 2001 and subsequent taxation years.

Clause 70

Corporation Tax Reductions

ITA
123.4

New section 123.4 of the Act contains rules that allow a corporation to reduce its tax otherwise payable under Part I of the Act by a percentage of the corporation's "full rate taxable income" – a term that is separately defined in the section for Canadian-controlled private corporations (CCPCs) and for other corporations. The applicable percentage will increase in stages from 1% for 2001 to 7% after 2003. Investment corporations, mortgage investment corporations, mutual fund corporations and non-resident owned investment corporations are not eligible for this rate reduction.

New section 123.4 also contains an additional rate reduction specific to CCPC's. This additional rate reduction is, in broad terms, equal to 7% of up to $100,000 of the CCPC's active business income in excess of the amount that benefits from the special rate for small-business income provided under section 125 of the Act.

Both the corporate rate reduction and the additional CCPC reduction apply to the 2001 and subsequent taxation years, and are prorated to reflect the number of days in a corporation's taxation year that fall in a given calendar year.

Definitions

ITA
123.4(1)

New subsection 123.4(1) of the Act sets out three definitions for the purposes of new section 123.4.

"CCPC rate reduction percentage"

A Canadian-controlled private corporation's "CCPC rate reduction percentage" for a taxation year is that proportion of 7% that the number of days in the corporation's taxation year that are after 2000 is of the total number of days in the year.

"full rate taxable income"

The "full rate taxable income" of a corporation for a taxation year is, in general terms, that part of the corporation's taxable income for the year that has not benefited from any of the various special effective tax rates provided under the Act. This amount is determined differently depending on the nature of the corporation. Paragraph (*a*) of the definition applies to corporations other than CCPCs and various "specialty corporations" such as investment corporations and mutual fund corporations. Paragraph (*b*) applies to CCPCs. Investment corporations, mortgage investment corporations, mutual fund corporations and non-resident-owned investment corporations are dealt with in paragraph (*c*); their full rate taxable income is nil.

Under paragraph (*a*), the full rate taxable income of a corporation is the amount by which the corporation's taxable income for the year exceeds the total of the following four amounts:

(i) 100/7 of any amount deducted by the corporation from its tax for the year as a manufacturing and processing profits deduction under subsection 125.1(1) of the Act;

(ii) if the corporation deducted from its tax, under subsection 125.1(2) of the Act, an amount relating to the creation of electrical energy for sale or steam used to create electrical energy, the amount determined by the formula in that subsection;

(iii) three times the total of all amounts claimed by the corporation under paragraph 20(1)(*v*.1) of the Act as resource allowances for the taxation year; and

(iv) if the corporation is a credit union and claimed the special deduction for credit unions under subsection 137(3) of the Act, 100/16 of amount claimed.

A corporation that is a CCPC throughout a taxation year must use paragraph (*b*) to calculate its full rate taxable income for the year. The full rate taxable income of such a CCPC is the amount by which the CCPC's taxable income for the year exceeds the total of the following items:

(i) The amounts that would be determined under subparagraphs (*a*)(i) to (iv) if paragraph (*a*) applied to the corporation;

(ii) 100/16 of the amount of the small business deduction claimed by the corporation for the year, under subsection 125(1) of the Act;

(iii) The corporation's aggregate investment income for the year, as defined in subsection 129(1) of the Act; and

(iv) 100/7 of any amount deducted under subsection 123.4(3) from the corporation's tax for the year (CCPC rate reduction – see below).

Paragraph (*c*) applies to corporations that throughout the year are investment corporations, mortgage investment corporations, mutual fund corporations or non-resident owned investment corporations. As noted above, these corporations have no full rate taxable income, and thus are not eligible for the rate reductions.

"general rate reduction percentage"

A corporation's "general rate reduction percentage" for a taxation year is a percentage that is computed by reference to the calendar year or years in which the taxation year falls. The percentage is the total of 1% for any portion of the taxation year that falls in 2001, 3% for any portion in 2002, 5% for 2003, and 7% for 2004 and later calendar years.

For example, if a corporation's taxation year begins on July 1, 2002 and ends on June 30, 2003, the corporation's general rate reduction percentage for the taxation year is approximately 3.99%, computed as follows:

	184/365 x 3%	=	1.51%
+	181/365 x 5%	=	2.48%
			3.99%

General Deduction from Tax

ITA
123.4(2)

New subsection 123.4(2) of the Act allows a corporation a deduction from its tax otherwise payable under Part I of the Act for a taxation year. The amount of the deduction is determined by multiplying the corporation's general rate reduction percentage for the year by the corporation's full-rate taxable income for the year.

CCPC deduction

ITA
123.4(3)

New subsection 123.4(3) of the Act allows a Canadian-controlled private corporation to deduct an amount from its tax otherwise payable for a taxation year under Part I of the Act. In general terms, as a result of this deduction the corporate tax rate on income between $200,000 and $300,000 earned by a CCPC from an active business carried on in Canada will be reduced to 21 per cent from 28 per cent, effective January 1, 2001. Associated corporations must share this deduction in proportion to their small business limit. Income eligible for this deduction is reduced to the extent that the corporation has income that has already benefited from a reduced effective tax rate. More particularly, the deduction is computed in a three-step process.

First, the corporation determines the least of the following three amounts:

(i) 3/2 of the corporation's business limit for the year as determined under section 125 of the Act for the purpose of paragraph 125(1)(*c*). This reference to all of section 125 ensures that the section's various modifications of the corporation's business limit apply for this purpose.

(ii) The amount that would have been the corporation's net active business income for the year, under paragraph 125(1)(*a*) of the Act, if the amounts contained in the description of M in the definition "specified partnership income" in subsection 125(7) of the Act were read as $300,000 and $822, instead of

$200,000 and $548, respectively. This adjustment – multiplying those amounts by 3/2 – ensures appropriate results in cases where the corporation has specified partnership income for the year.

(iii) Any excess of the amount determined under paragraph 125(1)(*b*), in respect of the corporation's taxable income for the year, over the corporation's aggregate investment income for the year as calculated under subsection 129(4) of the Act.

Second, the corporation subtracts from the least of the above amounts the total of the following:

(i) The total of the amounts that would have been determined under subparagraphs (*a*)(i) to (iv) of the definition "full-rate taxable income" had paragraph (*a*) of that definition applied to the corporation; and

(ii) 100/16 times the amount of the small business deduction claimed by the corporation under subsection 125(1) of the Act.

Third, any remainder is multiplied by the corporation's CCPC rate reduction percentage for the year. The product is the amount of the deduction for the year.

Clause 71

Manufacturing and Processing Profits Deduction

ITA
125.1

Section 125.1 of the Act provides a reduced rate of corporate tax on Canadian manufacturing and processing profits. Generally, the rate reduction takes the form of the deduction, from Part I tax otherwise payable, of an amount equal to a specified percentage – currently 7% – of a corporation's "Canadian manufacturing and processing profits" (other than profits eligible for the small business deduction under section 125 of the Act).

ITA
125.1(2) and (5)

The definition "Canadian manufacturing and processing profits" in subsection 125.1(3) of the Act provides, among other things, that such profits are to be determined under rules prescribed by regulation to be applicable to the "manufacturing or processing in Canada of goods for sale or lease". The definition "manufacturing or processing" in subsection 125.1(3) precludes certain activities from being "manufacturing or processing" activities to which the 7% corporate tax rate reduction in subsection 125.1(1) applies. The list of excluded activities includes producing or processing electrical energy or steam, for sale.

However, subsection 125.1(2) extends the 7% corporate tax rate reduction to a corporation that generates electrical energy for sale, or produces steam for use in the generation of electrical energy for sale. Subsection 125.1(2) is amended to also apply to the production of "steam for sale", regardless of the end use of the steam.

Subsection 125.1(5) provides rules of interpretation for the purpose of applying subsection 125.1(2) and related *Income Tax Regulations* (other than section 5201 of the Regulations). Paragraph 125.1(5)(*a*) provides that electrical energy is deemed to be a good for the purpose of computing the value of the description of A in subsection 125.1(2). Also, paragraph 125.1(5)(*b*) deems the generation of electrical energy for sale, or the production steam for use in the generation of electrical energy for sale, to be manufacturing or processing, subject to the 10% gross revenue rule in paragraph (*l*) of the definition "manufacturing or processing". Unless the 10% gross revenue rule is met by a corporation, the corporation’s activity is deemed to be excluded from the meaning of "manufacturing or processing".

For the purposes for which subsection 125.1(5) applies, paragraph 125.1(5)(*a*) is amended to deem steam to be a good and paragraph 125.1(5)(*b*) is amended to deem the production of "steam for sale" to be manufacturing or processing (other than for the purpose of applying the 10% gross revenue test in paragraph (*l*) of the definition "manufacturing or processing" in subsection 125.1(3)).

The tax rate reduction available under these changes is phased in beginning January 1, 2000, with a three percentage point tax rate

reduction for the calendar year 2000. The phase in to a full seven-percentage point tax rate reduction will be completed in 2002. The coming-into-force provision provides for a pro-ration of the tax rate reductions for taxation years that straddle calendar years. A taxation year could begin in 2001 and end in 2003 because of the 53-week taxation year rule, and because of this paragraphs (*f*) and (*g*) of the coming-into-force rule both refer to the 7% rate applicable to the calendar years 2002 and 2003, respectively.

Clause 72

Foreign Tax Credit

ITA
126

Section 126 of the Act provides rules under which a taxpayer's tax otherwise payable under Part I of the Act may be reduced by foreign taxes paid by the taxpayer. In general, these "foreign tax credits" are available only in respect of income or profits taxes paid to the government of another country (including the government of a political subdivision of the country).

Rules Relating to Unused Foreign Tax Credit

ITA
126(2.3)

Subsection 126(2.3) of the Act provides rules used to determine the unused foreign tax credit available for carryover to other taxation years. Consequential on the repeal of Part I.1, paragraphs 126(2.3)(*a*) and (*b*) are amended to remove the references to that Part, applicable to the 2001 and subsequent taxation years.

Foreign Oil and Gas Levies

ITA
126(5), (7)

New subsection 126(5) of the Act, together with several new definitions added to subsection 126(7), treats certain levies imposed

by a foreign government in connection with oil and gas businesses as income or profits taxes paid to the government.

These notes describe new subsection 126(5) and the new definitions in the order in which they will appear in the Act. However, because subsection 126(5) relies heavily on the new definitions, and because those definitions are themselves inter-related, readers may find that the best way to understand the provisions is to start by reviewing the definitions in the following order: "taxing country", "foreign oil and gas business", "commercial obligation", and "production tax amount", and only then to review new subsection 126(5).

These amendments (with the exception of the amendment to the definition "unused foreign tax credit" in subsection 126(7)) apply to taxation years that begin after December 31, 1999. However, if a taxpayer makes a written election to have these amendments apply to taxation years that begin after a designated date (which is earlier than December 31, 1999) and the election is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which these amendments receive royal assent, these amendments apply to taxation years that begin on the later of:

(i) the date so designated by the taxpayer in the election; and

(ii) December 31, 1994.

Foreign Oil and Gas Levies

ITA
126(5)

The general effect of new subsection 126(5) of the Act is to treat a taxpayer's "production tax amount" as a foreign income or profits tax, subject to a maximum of 40 per cent of the taxpayer's income from the business in question. Specifically, where a taxpayer is resident in Canada throughout a taxation year and carries on a "foreign oil and gas business" in a "taxing country" in the year, new subsection 126(5) treats the taxpayer as having paid in the year to the government of the country, as an income or profits tax, the lesser of two amounts. The first amount, described in new paragraph 126(5)(*a*), is the amount by which 40 per cent of the taxpayer's

income from the business in the country in the year exceeds the actual income and profits taxes (that is, those taxes determined without reference to this rule itself) paid in the year in respect of the business to the government of the country. The second amount, in new paragraph 126(5)(*b*), is the taxpayer's "production tax amount" for the business in the country in the year.

Definitions

ITA
126(7)

"commercial obligation"

A taxpayer who carries on a foreign oil and gas business in a country may simultaneously have more than one type of obligation to the government of the country or to an agent or instrumentality of that government. In the context of new subsection 126(5), which treats as foreign taxes certain amounts receivable by a foreign government, it is important to distinguish those obligations that can appropriately be treated as entailing income or profits taxes from those that are more in the nature of an ordinary commercial contract. The new definition "commercial obligation" describes the latter. A commercial obligation is one that the taxpayer has undertaken to a particular person, and that the law of the country would have allowed the taxpayer to undertake, on substantially the same terms, to a different person. (An obligation is not necessarily a commercial obligation, however, merely because it arises out of a contract.)

"foreign oil and gas business"

A taxpayer's foreign oil and gas business is a business the taxpayer carries on in a taxing country, the principal activity of which business is extracting petroleum, natural gas or related hydrocarbons from natural accumulations or from oil or gas wells.

"production tax amount"

The production tax amount of a taxpayer for a foreign oil and gas business carried on in a taxing country for a taxation year is the total of all amounts that meet the following four conditions.

First, the amounts must have become receivable in the year by the foreign country's government, because of the taxpayer's obligation (other than a commercial obligation) either to that government itself or to an agent or instrumentality of it.

Second, the amounts must be computed on a basis that takes into account the taxpayer's operating and capital costs. This does not mean that the computation must recognize all costs that would be deductible in computing the taxpayer's income for Canadian accounting or tax purposes. It means, rather, that the agreement or law that creates the obligation referred to above must allow for the deduction of some amount that is intended to account for the taxpayer's costs and that can reasonably be considered to have that effect.

Third, the amounts must not be income or profits taxes within the meaning of the Act read without reference to new subsection 126(5). Such taxes are already dealt with under the ordinary foreign tax credit rules, and need not be included in the taxpayer's production tax amount.

Finally, the amounts must not be identified as royalties, either in an agreement that creates the obligation or under the foreign country's law. Royalties are inherently not income or profits taxes, and it is not appropriate that any amount that is explicitly described as a royalty be indirectly characterized as an income tax by being included in the production tax amount.

"qualifying incomes"

"qualifying losses"

For commentary on the amendments to these two definitions, see the commentary on new subsection 126(9) of the Act.

"taxing country"

New subsection 126(5) in effect treats as income taxes certain levies imposed on a Canadian resident who carries on an oil or gas business in a foreign country. In order for the subsection to apply, the country in question must be one that regularly imposes an income tax on other business income. The definition "taxing country" incorporates

this principle: a taxing country is one whose government regularly imposes, in respect of business income, a levy or charge of general application that is (without reference to subsection 126(5)) an income or profits tax.

These amendments to subsection 126(7) apply to taxation years that begin after December 31, 1999. However, if a taxpayer makes a written election to have these amendments apply to taxation years that begin after a designated date (which is earlier than December 31, 1999) and the election is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which these amendments receive royal assent, these amendments apply to taxation years that begin on the later of:

(i) the date so designated by the taxpayer in the election; and

(ii) December 31, 1994.

"unused foreign tax credit"

Consequential on the repeal of Part I.1 of the Act, this definition is amended to remove the references to that Part, applicable to the 2001 and subsequent taxation years.

Calculation of Foreign Tax Credit

ITA
126(9)

Subsection 126(1) of the Act sets out the rules for claiming a credit in respect of foreign taxes on non-business income (that is, the foreign taxes imposed on investment income and other categories of foreign source non-business income). A credit in respect of foreign taxes on business income is provided under subsection 126(2). Neither credit may exceed the Canadian tax otherwise payable in respect of the foreign source income. Canadian tax otherwise payable on foreign source income is generally determined by reference to the ratio of the net income from sources in a foreign country to total income. The net foreign source income is the amount, if any, by which "qualifying incomes" (as defined in subsection 126(7)) from

those sources exceeds "qualifying losses" (as defined in the same subsection) from those sources.

The definitions "qualifying income" and "qualifying losses" are amended such that all the rules for determining those amounts are included in new subsection 126(9) – rather than in the body of the definitions – and that the definitions contain references to that subsection.

New subsection 126(9) sets out the amended rules for determining "qualifying incomes" and "qualifying losses". These amended rules consist of the existing rules (that is, those rules that are found in the body of the existing definitions) as well as certain new additional rules. These additional rules relate to deductions under certain provisions of the Act (in these notes referred to as the "particular resource deduction provisions"), namely subsections 66(4) and 66.7(2) and new subsections 66.21(4) and 66.7(2.3) of the Act. Under these additional rules, the qualifying incomes and qualifying losses for a taxation year of a taxpayer from sources in a country are determined as if such portion of the total amount deducted under the particular resource deduction provisions as applies to those sources were the greater of:

- the total amount actually deducted in respect of those sources under the particular resource deduction provisions; and

- the maximum amount that would be deductible in respect of those sources under the particular resource deduction provisions if specified assumptions were made. These assumptions, in general terms, ignore the taxpayer's income from other sources.

This amendment applies to taxation years that begin after December 31, 1999. However, if a taxpayer makes a written election to have this amendment apply to taxation years that begin after a designated date (which is earlier than December 31, 1999) and the election is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this amendment receives royal assent, the amendment applies to taxation years that begin on the later of:

(i) the date so designated by the taxpayer in the election; and

(ii) December 31, 1994.

Clause 73

Investment Tax Credit

ITA
127

Section 127 of the Act includes a set of provisions governing a taxpayer's entitlement to claim an investment tax credit (ITC).

ITA
127(5)

Subsection 127(5) of the Act provides for the deduction of investment tax credits from a taxpayer's Part I (and, for taxation years before 2001, Part I.1) tax otherwise payable for a taxation year. The term "investment tax credit" is defined in subsection 127(9) of the Act.

Subparagraph 127(5)(*a*)(i) provides that the taxpayer's investment tax credit at the end of the year in respect of property acquired before the end of the year or of the taxpayer's SR&ED qualified expenditure pool at the end of the year or of a preceding taxation year may be deducted in computing the taxpayer's tax payable for the year under Part I of the Act. For the 2000 and subsequent taxation years, subparagraph 127(5)(*a*)(i) is amended to ensure that the taxpayer's investment tax credit at the end of the year in respect of the taxpayer's flow-through mining expenditure for the year or a preceding taxation year may also be deducted in computing the taxpayer's tax payable for the year. The new term "flow-through mining expenditure" is added to the definitions in subsection 127(9).

Clause 127(5)(*a*)(ii)(A) provides that the taxpayer's investment tax credit at the end of the year in respect of property acquired in a subsequent taxation year or of the taxpayer's SR&ED qualified expenditure pool at the end of a subsequent taxation year may be deducted in computing the taxpayer's tax payable for the year. For the 2000 and subsequent taxation years, clause 127(5)(*a*)(ii)(A) is amended to ensure that the investment tax credit in respect of the taxpayer's flow-through mining expenditure for a subsequent year

may also be deducted in computing the taxpayer's tax payable under Part I. The new term "flow-through mining expenditure" is added to the definitions in subsection 127(9).

Consequential on the repeal of Part I.1 of the Act (i.e., the provisions relating to the individual surtax) for the 2001 and subsequent taxation years, the reference, in clause 127(5)(*a*)(ii)(A), to subsection 180.1(1.2) is removed for the 2001 and subsequent taxation years. For details concerning the repeal of Part I.1, refer to the commentary on Part I.1.

Paragraph 127(5)(*b*) describes an amount that may be deducted for a taxation year by a taxpayer where the taxpayer is subject to the minimum tax for the year. Consequential on the repeal of Part I.1 of the Act (i.e., the provisions relating to the individual surtax) for the 2001 and subsequent taxation years, paragraph 127(5)(*b*) is amended to remove the reference to subsection 180.1(1.2) for those years. For details concerning the repeal of Part I.1, refer to the commentary on Part I.1.

Definitions

ITA
127(9)

Subsection 127(9) of the Act provides definitions that apply for the purposes of section 127.

"investment tax credit"

The definition "investment tax credit" in subsection 127(9) of the Act provides for the determination of a taxpayer's investment tax credit (ITC) at the end of a taxation year.

Paragraph (*a*.1) of the definition "investment tax credit" in subsection 127(9) is amended to require taxpayers to reduce the base on which the investment tax credit (ITC) is computed. Existing paragraph (*a*.1) of the definition requires the inclusion of 20% of the taxpayer's scientific research and experimental development (SR&ED) qualified expenditure pool for a year in the taxpayer's ITC. New paragraph (*a*.1) of the definition requires the inclusion of 20% of the amount by which a corporation's SR&ED qualified expenditure pool for a year

exceeds the corporation's super-allowance benefit amount for each province to which it applies. See the commentary below on the new definition "super-allowance benefit amount".

The amendment to paragraph (*a*.1) of the definition "investment tax credit" applies to taxation years that begin after February 2000 except that, for corporations whose first taxation year that begins after February 2000 ends before 2001, the amendment applies to taxation years that begin after 2000.

New paragraph (*a*.2) of the definition provides that, where the taxpayer is an individual (other than a trust), 15% of the taxpayer's flow-through mining expenditures at the end of a taxation year is added to the taxpayer's ITC at the end of the year. (The new expression "flow-through mining expenditure" is added to the definitions in subsection 127(9). See the commentary on subsection 127(9) for further details.)

Paragraph (*c*) of the definition of "investment tax credit" provides for a three-year carryback and ten-year carryforward of unused ITCs in respect of which an amount is determined under paragraph (*a*), (*a*.1) or (*b*) of that definition. Paragraph (*c*) of the definition is amended to add a reference to new paragraph (*a*.2) to ensure that amounts determined in respect of paragraph (*a*.2) have the same carryover period.

The amendments to the definition "investment tax credit" generally apply after October 17, 2000.

"flow-through mining expenditure"

The term "flow-through mining expenditure" is added to subsection 127(9) of the Act to define an expenditure that qualifies for the 15% investment tax credit, available to a taxpayer who is an individual (other than a trust), as provided for in new paragraph (*a*.2) of the definition "investment tax credit" in subsection 127(9). See the commentary on the definition "investment tax credit" for further details.

A flow-through mining expenditure of a taxpayer for a taxation year generally means an expense that is considered by the Act to have been incurred by the taxpayer in the year as a result of a renunciation

by a corporation under an agreement for the issue of a flow-through share (this expense being referred to in this commentary as an "investor mining expense") and that meets certain additional conditions set out in paragraphs (*a*) to (*e*) of the definition "flow-through mining expenditure".

The term "flow-through share" is defined in subsection 66(15) of the Act. A flow-through share is generally a share of the capital stock of a principal-business corporation that is issued to a person pursuant to an agreement in writing under which the corporation agrees to incur resource expenses and to renounce those expenses to that person. The term "principal-business corporation" is also defined for these purposes in subsection 66(15). A principal-business corporation for these purposes is generally a corporation the principal business of which is exploration and development of minerals or other resources. Subsection 66(12.6) of the Act permits such a principal-business corporation to renounce its Canadian exploration expenses (CEE) to its flow-through shareholders. In general, where a corporation renounces CEE to a shareholder under subsection 66(12.6), the shareholder is deemed by subsection 66(12.61) to have incurred CEE on the effective date of the renunciation.

In some cases, the agreement for the issue of the flow-through share is between the renouncing corporation and a partnership. Paragraph (*h*) of the definition "Canadian exploration expense" in subsection 66.1(6) of the Act provides, in general, that the taxpayer's share of any CEE actually incurred (or deemed incurred) in a fiscal period by a partnership is considered to be CEE of the taxpayer, if at the end of that fiscal period the taxpayer is a member of the partnership. Under subsection 66(18) of the Act, the taxpayer's CEE is deemed to have been incurred at the end of that fiscal period.

An investor mining expense incurred by a taxpayer in a taxation year is an expense deemed incurred by a taxpayer in the year because of

- subsection 66(12.61)

  (i.e., the case where the agreement for the issue of the flow-through share is between the renouncing corporation and the taxpayer)

or

- subsection 66(18) as a consequence of the application of subsection 66(12.61) to the partnership of which the taxpayer is a member

  (i.e., the case where the agreement for the issue of the flow-through share is between the renouncing corporation and a partnership of which the taxpayer is a member).

An investor mining expense incurred by a taxpayer in a taxation year is a "flow-through mining expenditure" of a taxpayer for the year if the expense meets the requirements set out in paragraphs (*a*) to (*e*) of the definition "flow-through mining expenditure" and discussed below.

Paragraph (*a*) of the definition "flow-through mining expenditure" requires that the expense be a CEE incurred after October 17, 2000 and before 2004 by a corporation in conducting mining exploration activity from or above the surface of the earth for the purpose of determining the existence or location of a mineral resource described in paragraph (*a*) or (*d*) of the definition "mineral resource" in subsection 248(1) of the Act.

Paragraph (*b*) of the definition "flow-through mining expenditure" requires that the expense be an expense that would be described in paragraph (*f*) of the definition "Canadian exploration expense" in subsection 66.1(6) of the Act if that paragraph were read to exclude expenses in respect of digging test pits and preliminary sampling.

Paragraph (*c*) of the definition "flow-through mining expenditure" requires that the agreement described in subsection 66(12.6) of the Act between the renouncing corporation and the flow-through shareholder be made after October 17, 2000.

Paragraph (*d*) of the definition "flow-through mining expenditure" contemplates the possibility that expenses renounced by the corporation to the taxpayer (or to a partnership of which the taxpayer is a member) were not actually incurred by the corporation. This is possible where expenses are deemed to have been incurred by the corporation as a result of a renunciation by another corporation under subsection 66(12.6) of the Act (referred to in this commentary as the "prior renunciation") to the corporation. Paragraph (*d*) requires that in these cases the prior renunciation be made under an agreement that

is described in subsection 66(12.6) and is made between the corporations after October 17, 2000.

Paragraph (*e*) of the definition "flow-through mining expenditure" contemplates the effect of subsection 66(12.66) of the Act on the timing of expenses. As described above, paragraph (*a*) requires that the expense be incurred by the corporation before 2004. Subsection 66(12.66) deals with certain types of resource expenses and generally allows a corporation to renounce, effective on the last day of the preceding calendar year, resource expenses that the corporation intends to incur in the current calendar year. In the absence of paragraph (*e*), expenses incurred by the corporation in 2004 and deemed by subsection 66(12.66) to have been incurred by the corporation in 2003 might otherwise meet the pre-2004 test in paragraph (*a*). Accordingly, paragraph (*e*) requires that the expense be an expense that would be incurred by the corporation before 2004 if the Act were read without reference to subsection 66(12.66).

This new definition applies after October 17, 2000.

"super-allowance benefit amount"

The "super-allowance benefit amount" of a corporation for a taxation year is calculated by reference to the formula (A - B) x C. The factor (A - B) describes the amount by which a provincial income tax deduction exceeds the SR&ED expenditure otherwise determined (without reference to provincial income tax credits). Variable C is the provincial rate of tax to be applied to convert the excess deduction into a tax-credit equivalent. For corporations with an expenditure limit for the year for SR&ED purposes (as determined under subsection 127(10.2)) that is greater than nil, the applicable tax rate for variable C is the rate that the province applies to small business income earned in the year. Where the taxpayer's expenditure limit is nil, the applicable rate is the general corporate income tax rate for the year in the province for active business income.

The new definition "super-allowance benefit amount" applies to taxation years that begin after February 2000 except that, for corporations whose first taxation year that begins after February 2000 ends before 2001, the amendment applies to taxation years that begin after 2000.

ITA
127(10.1)

Subsection 127(10.1) of the Act provides an additional 15% ITC to Canadian-controlled private corporations, based on the least of the amount that the corporation claims (paragraph 127(10.1)(*a*)), the corporation's SR&ED qualified expenditure pool for the year (paragraph 127(10.1)(*b*)) and the corporation's expenditure limit for the year (paragraph 127(10.1)(*c*)). Subsection 127(10.1) is amended to reduce the amount determined under paragraph 127(10.1)(*b*) by the taxpayer's super-allowance benefit amount for the year for each province to which it applies.

This amendment applies to taxation years that begin after February 2000 except that, for corporations whose first taxation year that begins after February 2000 ends before 2001, this amendment applies to taxation years that begin after 2000.

ITA
127(11.1)

Subsection 127(11.1) of the Act sets out various rules for determining amounts to be included for the purpose of the definition "investment tax credit" in subsection 127(9) of the Act. These rules provide for the reduction of capital cost and qualified expenditures by certain amounts that qualify as assistance or contract payments.

New paragraph 127(11.1) (*c*.2) reduces a taxpayer's "flow-through mining expenditure" (as newly defined in subsection 127(9)) by the amount of assistance that the taxpayer has received, is entitled to receive or can reasonably be expected to receive relating to expenses included in determining the taxpayer's flow-through mining expenditure.

The amendments to subsections 127(5) and (11.1) apply to the 2000 and subsequent taxation years.

The amendment to subsection 127(9) applies after October 17, 2000.

Clause 74

Minimum Tax

ITA
127.52

Section 127.52 of the Act defines the "adjusted taxable income" of an individual for a taxation year for the purpose of determining the individual's minimum tax liability under Part I of the Act.

Adjusted Taxable Income Determined

ITA
127.52(1)

Subsection 127.52(1) of the Act defines an individual's adjusted taxable income for a taxation year for the purpose of determining the individual's minimum tax liability under Part I of the Act, and generally requires that the portion of capital gains that is not included in income, because of the inclusion rate, be added in computing adjusted taxable income.

The amendments replace the reference to the fraction "3/4" with a reference to the fraction "1/2" in subparagraph 127.52(1)(*d*)(i) (realized capital gains), replace the reference to the expression "4/3 of" with a reference to the word "twice" in subparagraph 127.52(1)(*d*)(ii) (gains allocated from a trust) and replace the reference to the fraction "1/3" with a reference to the fraction "1/2" in subparagraph 127.52(1)(*g*)(ii) (gains allocated by a trust).

The amendments are consequential on the reduction of the inclusion rate from 3/4 to 1/2 and generally apply to taxation years that end after February 27, 2000. For taxation years that include either February 28, 2000 or October 17, 2000;

- the reference to the fraction "1/2" in subparagraph 127.52(1)(*d*)(i) is to be read as a reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the taxpayer for the year,

- the reference to the word "twice" in subparagraph 127.52(1)(*d*)(ii) is to be read as reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the taxpayer for the year, multiplied by", and

- the reference the fraction "1/2" in subparagraph 127.52(1)(*g*)(ii) is to be read as reference to the expression "the fraction that is equal to the amount obtained when 1 is subtracted from the reciprocal of the fraction in paragraph 38(*a*) that applies to the trust for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

ITA
127.52(1)(*e*) and (*e*.1)

"Adjusted taxable income" is calculated on the basis of the various assumptions set out in paragraphs 127.52(1)(*a*) to (*j*). Paragraph 127.52(1)(*e*) provides that "adjusted taxable income" is computed on the assumption that the total of specified resource-related deductions does not exceed specified resource income. Paragraph 127.52(1)(*e*.1) provides that "adjusted taxable income" is computed on the assumption that financing expenses deductible under paragraphs 20(1)(*c*) to (*f*) in respect of the acquisition of flow-through shares, Canadian resource properties or foreign resource properties do not exceed the amount by which the same specified resource income exceeds the same specified resource-related deductions.

Paragraphs 127.52(1)(*e*) and (*e*.1) are amended so that the resource-related deductions so specified include the deduction under new subsection 66.21(4).

These amendments apply to taxation years that begin after 2000.

Clause 75

Where Individual Bankrupt

ITA
128(2)(*e*) and (*f*)

Subsection 128(2) of the Act contains rules that apply to individuals who become bankrupt.

Paragraph 128(2)(*e*) requires a trustee in bankruptcy to file, for each taxation year in the calendar year in which an individual becomes bankrupt, an income tax return with respect to certain income of the estate and businesses of the individual. For this purpose, the individual's income is to be determined as if no deductions other than those specifically listed were available to the individual.

Paragraph 128(2)(*e*) is amended to include in the list of allowable deductions a deduction under new paragraph 110(1)(*d*.01) of the Act. Paragraph 110(1)(*d*.01) allows a deduction where certain employee option securities (or proceeds from the disposition of such securities) are donated to a qualifying charity. This deduction is available to the extent that the securities option benefit to which the deduction relates is included in computing the individual's taxable income for the taxation year for which the return is being filed.

Paragraph 128(2)(*f*) requires an individual who is bankrupt at any time in a taxation year to file an income tax return for the year, in addition to the return required under paragraph 128(2)(*e*) to be filed by the trustee in bankruptcy. For this purpose, the individual's income is to be determined as if certain listed deductions were not available.

Paragraph 128(2)(*f*) is amended to include in the list of deductions that are not available a deduction under new paragraph 110(1)(*d*.01).

These amendments apply to the 2000 and subsequent taxation years.

Clause 76

Mortgage Investment Corporations

ITA
130.1

Section 130.1 of the Act sets out rules that apply to mortgage investment corporations and their shareholders. A mortgage investment corporation is essentially treated as a conduit in that its income may be flowed through to its shareholders and taxed in their hands rather than in the corporation.

Deduction from Tax

ITA
130.1(1)(*a*)(ii)

Subsection 130.1(1) of the Act provides rules for calculating the income of a mortgage investment corporation for a taxation year. The amendment to subparagraph 130.1(1)(*a*)(ii) replaces the reference to the fraction "3/4" with a reference to the fraction "1/2", consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year of a mortgage investment corporation that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "1/2" is to be read as reference to the fraction in amended paragraph 38(*a*) of the Act that applies to the corporation for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Election re Capital Gains Dividend

ITA
130.1(4)

Where a mortgage investment corporation elects in respect of the full amount of a dividend, subsection 130.1(4) of the Act deems the dividend to be capital gains dividend to the extent that it does not exceed 4/3 of the undistributed taxed capital gains of the corporation

for the year, and the dividend is deemed to be a capital gain of the dividend recipient from the disposition of property in the year in which the dividend was received.

The amendment to subparagraph 130.1(4)(*a*)(i) replaces the reference to the expression "4/3 of" with a reference to the word "twice". The amendment is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year of a mortgage investment corporation that includes either February 28, 2000 or October 17, 2000, the reference the word "twice" in subparagraph 130.1(4)(*a*)(i) is to be read as reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the corporation for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Capital Gains Dividend – Reporting and Allocation

ITA
130.1(4.2) and (4.3)

Subsection 130.1(4) of the Act applies where a dividend is payable by a mortgage investment corporation and the corporation elects to have the dividend deemed to be a capital gains dividend. Where that subsection applies in respect of a dividend paid in a taxation year by a mortgage investment corporation to a shareholder of any class of shares of its capital stock, new subsection 130.1(4.2) requires the corporation to disclose to the shareholder in prescribed form the amount of the dividend that can reasonably be considered to have been paid out of its capital gains realized on dispositions by the corporation of property in each of the following three periods in the year:

- before February 28, 2000;
- after February 27, 2000 and before October 18, 2000; and
- after October 17, 2000.

If it does not do so, the dividend is deemed to be in respect of capital gains realized on dispositions of property that occurred before February 27, 2000.

New subsection 130.1(4.3) provides that a mortgage investment corporation can elect, for its taxation year that includes either February 28, 2000 or October 17, 2000, to apportion its capital gains dividends for the year amongst the three periods in the year described above.

The portion for each period is determined to be that proportion of the dividend that the number of days that are in the year and in that period is of the number of days in the year.

New subsections 130.1(4.2) and (4.3) apply to taxation years that end after February 27, 2000.

Clause 77

Mutual Fund Corporations

ITA
131

Section 131 sets out rules relating to the taxation of mutual fund corporations and their shareholders.

Election re Capital Gains Dividend

ITA
131(1)(*b*)

Where a mutual fund corporation elects in respect of the full amount of a dividend, the dividend, to the extent that it does not exceed the corporation's capital gains dividend account, is deemed to be a capital gains dividend and the dividend recipient is deemed to have a capital gain for the taxation year in which the dividend is received from the disposition of property in the year.

The amendment to paragraph 131(1)(*b*) of the Act, which is applicable for taxation years that end after February 27, 2000, is

consequential on the change to the inclusion rate for capital gains. The amendment ensures that the inclusion rate for capital gains realised on property disposed of prior to February 27, 2000 is 3/4.

Where the taxation year of the dividend recipient began after February 27, 2000 and ended before October 18, 2000 and the capital gains dividend was paid out of capital gains from property disposed of before February 27, 2000, under subparagraph 131(1)(*b*)(i) 9/8 of the dividend is deemed to be a capital gain from the disposition of property.

Where the taxation year of the dividend recipient began before and ended after February 27, 2000 and the capital gains dividend was paid out of capital gains from property disposed of before February 27, 2000, under subparagraph 131(1)(*b*)(ii) the dividend is deemed to be a capital gain of the recipient from property disposed of before February 27, 2000.

Where the taxation year of the dividend recipient began after October 17, 2000 and the capital gains dividend was paid out of capital gains from property disposed of after February 27, 2000 and before October 18, 2000, under subparagraph 131(1)(*b*)(iii) 4/3 of the dividend is deemed to be a capital gain of the recipient from property disposed in the year.

Where the taxation year of the dividend recipient includes October 17, 2000 and the capital gains dividend was paid out of capital gains from property disposed of after February 27, 2000 and before October 18, 2000, under subparagraph 131(1)(*b*)(iv) the dividend is deemed to be a capital gain of the recipient from property disposed in the year and before October 18, 2000. In any other case, under subparagraph 131(1)(*b*)(v) the dividend is deemed to be a capital gain of the taxpayer from property disposed of after October 17, 2000 and in the year the dividend was received.

Capital Gains Dividend

ITA
131(1.5) and (1.6)

Section 131(1) of the Act applies where a dividend is payable by a mutual fund corporation and the corporation elects the dividend to be a capital gains dividend.

Section 131(1) is amended to add new subsections 131(1.5) and (1.6), applicable for taxation years that end after February 27, 2000.

Where a capital gains dividend is paid by a mutual fund corporation to a shareholder of any class of shares of its capital stock, new subsection 131(1.5) provides that the corporation must disclose to the shareholder in prescribed form the amount of the dividend that can reasonably be considered to have been paid out of its capital gains realized on dispositions by the corporation of property before February 28, 2000, after February 27, 2000 and before October 18, 2000, and after October 17, 2000. If it does not do so, the dividend is deemed to be in respect of capital gains realized on dispositions of property that occurred before February 28, 2000.

New subsection 131(1.6) of the Act provides that a mutual fund corporation can elect, for its taxation year that includes either February 28, 2000 or October 17, 2000, to treat a portion of its capital gains dividends for the year to be in respect of capital gains realized on dispositions of property

- before February 28, 2000,
- in the period that begins at the beginning of February 28, 2000 and ends at the end of October 17, 2000, and
- in the period that begins at the beginning of October 18, 2000 and ends at the end of the year.

The portion is determined as that proportion of the dividend that the number of days that are in the year and in that period is of the number of days in the year.

Capital Gains Refund to Mutual Fund Corporation

ITA
131(2)(*a*)

A mutual fund corporation is entitled to a capital gains refund for a taxation year equal to the lesser of 21% of the total of its capital gains dividends paid for the year, its capital gains redemptions for the year and the amount of its refundable capital gains tax on hand at the end of the year.

Generally, the refundable capital gains tax on hand of a mutual fund corporation is 28% of its taxed capital gains (or 21 % of its capital gains for the year where the relevant inclusion rate for capital gains is 3/4). The refundable capital gains tax on hand could be less then 21% of capital gains where taxable income of the mutual fund corporation is less than its taxed capital gains.

The amendments to paragraph 131(2)(*a*) of the Act replace the reference to "21%" with the reference to "14%", and add that the Minister can determine another amount after giving consideration to the percentages applicable in determining the corporation's capital gains refund and refundable capital gains tax on hand for the year and preceding taxation years. These amendments are consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendments apply to taxation years that end after February 27, 2000 except that, for the taxation year of a mutual fund corporation that includes either February 28, 2000 or October 17, 2000, the reference to the percentage "14%" in subparagraph 131(2)(*a*)(i) is to be read as reference to the percentage determined when 28 % is multiplied by the fraction in amended paragraph 38(*a*) of the Act that applies to the corporation for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Definitions

ITA
131(6)

"capital gains dividend account"

The "capital gains dividend account" of a mutual fund corporation represents the cumulative net undistributed capital gains of the corporation on which it paid refundable capital gains tax.

In determining its capital gains dividend account balance, a mutual fund corporation must deduct 100/21 of its capital gains refunds for the year, representing capital gains distributions in respect of which the corporation received capital gains refunds.

The amendment to subparagraph (*b*)(iii) of the definition "capital gains dividend account" is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2 for taxation years that end after February 27, 2000. With the inclusion rate reduction to 1/2 and using a 28% corporate tax rate, refundable tax and refunds approximate 14% of capital gains. For taxation years that ended before February 28, 2000, the rate remains unchanged at 21%.

The amendment applies to taxation years that end after February 27. 2000 except that, for the taxation year of a mutual fund corporation that includes either February 28, 2000 or October 17, 2000, the reference to the percentage "14 %" in subsection 131(6)(*b*)(iii)(B) of the Act is to be read as reference to the fraction "100/28X", where "X" is the fraction in amended paragraph 38(*a*) of the Act that applies to the corporation for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

"capital gains redemptions"

The "capital gains redemptions" of a mutual fund corporation for a year are used in determining the mutual fund corporation"s capital gains refund for the year. In calculating the capital gains redemptions, the corporation must allocate accrued capital gains and undistributed realized net capital gains across all payments on the redemptions of shares in the year.

The amendment to the description of C in the definition "capital gains redemptions" replaces the fraction "100/21" with the fraction "100/14", and is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for the taxation year of a mutual fund corporation that includes either February 28, 2000 or October 17, 2000, the reference to the fraction "100/14" in the description of C in the definition "capital gains redemptions" in subsection 131(6) is to be read as reference to fraction "100/28X", where "X" is the fraction in amended paragraph 38(*a*) that applies to the corporation for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 78

Mutual Fund Trusts

ITA
132

Section 132 provides for a refund to a mutual fund trust in respect of the tax which the fund has paid on its capital gains distributed to its beneficiaries through a redemption of units. This mechanism is to avoid double taxation.

Capital Gains Refunds to Mutual Fund Trusts

ITA
132(1)(*a*)

A mutual fund trust is entitled to capital gains refund for a year equal to the lesser of 21.75% of its capital gains redemptions for the year and its refundable capital gains tax on hand at the end of the year.

The 21.75% rate is based a trust tax rate of 29% and a 3/4 inclusion rate for capital gains. The rate is changed to 14.5%, applicable to taxation years that end after February 27, 2000 and the Minister will be able to determine another amount after giving consideration to the percentages applicable in determining the trust's capital gains refund

for the year and preceding taxation years. Those changes are consequential on the decrease of the inclusion rate for capital gains from 3/4 to 1/2.

The amendments apply to taxation years that end after February 27, 2000 except that, for the taxation year of a mutual fund trust that includes either February 28, 2000 or October 17, 2000, the reference to the percentage "14.5%" in subparagraph 132(1)(*a*)(i) of the Act is to be read as reference to the percentage determined when 29% is multiplied by the fraction in amended paragraph 38(*a*) of the Act that applies to the trust for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Definitions

ITA
132(4)

Subsection 132(4) of the Act defines two expressions for the purpose of the section 132.

"capital gains redemptions"

The capital gains redemptions of a mutual fund trust for a year are used in determining the mutual fund trust's capital gains refund for the year. In calculating the capital gains redemptions, the trust must allocate accrued capital gains and undistributed realized net capital gains across all payments on the redemptions of units in the year. The first amendment replaces the first formula in the definition "capital gains redemptions" in subsection 132(4) of the Act. The new formula provides for the deduction of an amount "E" in the calculation of the amount of the trust's capital gains redemptions. The amendment applies to taxation years that end after February 27, 2000.

The second amendment replaces the description of A in the definition. The amended description refers to the portion of payments on the redemption of units that are included in the proceeds of disposition in respect of the redeemed units. The amendment applies to taxation years that end after February 27, 2000.

The third amendment replaces the fraction "100/21.75" with the fraction "100/14.5" in the description of C in the definition , and is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2. The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year of a mutual fund trust that includes either February 28, 2000 or October 17, 2000 the references to the fraction "100/14.5" in the description of C in the definition "capital gains redemptions" in subsection 132(4) is to be read as a reference to the fraction "100/29X", where "X" is the fraction in amended paragraph 38(*a*) of the Act that applies to the trust for the year.

The last amendment adds the description of E. This refers to twice the total of all amounts each of which is an amount designated by the trust under subsection 104(21) of the Act in respect of units redeemed by the trust in the year and after announcement date. The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year of a mutual fund trust that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" is to be read as a reference to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) that applies to the taxpayer for the year, multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 79

Non-Resident-Owned Investment Corporations

ITA
133

Section 133 of the Act provides rules for the taxation of non-resident-owned investment corporations (NROs) on a basis that attempts to approximate the tax treatment that would apply if their non-resident shareholders held investments directly. Pursuant to changes announced in the 2000 Budget, NROs are to be phased out over a three-year period, effective after February 27, 2000.

The 2000 Budget also announced that existing NROs will not be permitted to increase their overall assets or debt during the three-year phase-out period.

The phase out of NROs is given effect through the amended definition "non-resident-owned investment corporation" and the new definition "increase in capital" in subsection 133(8). See the commentary on those definitions for further details.

Computation of Income

ITA
133(1)(*d*)

Subsection 133(1) of the Act provides rules for the purposes of determining the income and the taxable income of a non-resident owned investment corporation.

The amendment to paragraph 133(1)(*d*) replaces the reference to the expression "4/3 of" with a reference to the word "twice". It is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

This amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year that includes either February 28, 2000 or October 17, 2000, the reference to the word "twice" is to be read as reference to the expression "the fraction that is the reciprocal fraction in paragraph 38(*a*) that applies to the corporation for the year multiplied by". These modifications are required in order to reflect the capital gains/losses rate for the year.

Definitions

ITA
133(8)

Subsection 133(8) of the Act sets out certain definitions that apply for the purposes of section 133.

"non-resident-owned investment corporation"

Paragraph (*e*) of the definition "non-resident-owned investment corporation" in subsection 133(8) provides that a corporation that wishes to be treated as an NRO must have elected to be taxed as an NRO on or before the day that is 90 days after the beginning of its first taxation year that begins after 1971. This paragraph is amended to require the election to have been made on or before the earlier of that day and February 27, 2000. New paragraph (*h*) provides that a corporation created through the amalgamation of two or more corporations, each of which elected in a timely manner under amended paragraph (*e*) to be taxed as an NRO, will be able to elect after February 27, 2000 to be taxed as an NRO. New paragraph (*i*) gives effect to the three-year phase-out period for all NROs, including those created through amalgamations referred to in new paragraph (*h*), by providing that no corporation is an NRO in any taxation year that ends after its last taxation year that begins before 2003. New paragraph (*i*) provides that, if at any time during the three-year phase-out period, a corporation effects an "increase in capital" (as defined in subsection 133(8)), it will lose its status as an NRO for any taxation year that ends after that time.

The amended definition "non-resident-owned investment corporation" applies after February 27, 2000.

"increase in capital"

The new definition "increase in capital" in subsection 133(8) defines an increase in capital to be a transaction in the course of which a corporation issues additional shares or incurs indebtedness, where the transaction has the effect of increasing the total of the corporation's liabilities and the fair market value of all of its shares to an amount that is substantially greater than that total was on February 27, 2000. Transactions carried out pursuant to an agreement in writing made before February 28, 2000 are exempted from this rule.

A number of consequences that follow from this definition should be noted. First, since the "total" referred to is of both the liabilities of the corporation and the fair market value of all of its shares, an increase in either will increase this "total". For example, if a corporation incurs debt to acquire a new asset, the total fair market value of its shares may remain the same, but its liabilities will

increase, thus increasing the "total". Second, an increase in the fair market value of a corporation's shares that results from market appreciation of the value of its assets will not by itself be an "increase in capital", because the definition requires that there be a transaction involving the issuance of shares or the incurring of indebtedness. Finally, since the issuance of additional shares through the payment of stock dividends does not ordinarily increase the fair market value of a corporation's shares or increase its liabilities, such a payment of stock dividends will not be an "increase in capital."

The new definition "increase in capital" applies after February 27, 2000.

Clause 80

Non-Resident-Owned Investment Corporations – Transition

ITA
134.1

New section 134.1 of the Act provides special transitional rules to accommodate the phase out of non-resident-owned investment corporations (NROs). The present NRO rules allow an NRO to claim a refund of its 25% refundable tax when it pays dividends to its non-resident shareholders (at which time the dividend withholding tax in Part XIII of the Act applies). However, to access the pool of refundable tax for a given taxation year, the refund mechanism requires dividends to be paid in a subsequent taxation year. Since the amended definition "non-resident-owned investment corporation" in subsection 133(8) calls for the phase-out of NROs over a three-year period, a corporation that ceases to be an NRO would not be able to claim a refund of the 25% refundable tax that it would pay in respect of its last taxation year as an NRO. To accommodate the refund of this tax, new paragraph 134.1(1)(*c*) provides an election through which a corporation that ceases to be an NRO can elect to have its status as an NRO extended for this specific purpose for its first non-NRO year.

New section 134.1 applies to taxation years that end after 1996. An election under the section is treated as having been made in a timely manner if it is made on or before the electing corporation's filing-due

date for its first taxation year that ends after this amendment receives Royal Assent.

Clause 81

Deferred Profit Sharing Plans

ITA
147

Section 147 of the Act contains rules relating to deferred profit sharing plans (DPSPs).

Order of Disposal of Shares

ITA
147(10.5)

Subsection 147(10.5) of the Act contains a special ordering rule which provides that, for the purposes of subsection 147(10.4) of the Act, identical shares are considered to have been disposed of in the order in which they were acquired. Subsection 147(10.4) provides that, in certain circumstances, an employee who receives employer shares on withdrawing from a DPSP must include in income in the year the shares are disposed of the excess of the fair market value of the shares at the time of the withdrawal over the cost amount of the shares to the DPSP.

Subsection 147(10.5) is repealed. This is consequential on subsection 7(1.3) of the Act being amended to have that subsection apply for the purposes of subsection 147(10.5) with respect to shares acquired after February 27, 2000, and to shares acquired before February 28, 2000 but not disposed of before that date. (See the commentary on subsection 7(1.3) for further details.)

Clause 82

Electronic Filing

ITA
150.1(5)

Section 150.1 of the Act provides for the use of electronic media for filing tax returns. The amendment to subsection 150.1(5) is strictly consequential on the repeal of the surtax imposed on individuals under Part I.1 of the Act (see commentary on that Part).

This amendment applies to the 2001 and subsequent taxation years.

Clause 83

Tax Instalments

ITA
156.1(1)

"net tax owing"

Subsection 156(1) of the Act sets out definitions that are relevant in determining whether an individual is required to make tax instalments. The amendment to the definition "net tax owing" is strictly consequential on the repeal of the surtax imposed on individuals under Part I.1 of the Act (see commentary on that Part).

This amendment applies to the 2001 and subsequent taxation years.

Clause 84

Realization of Deceased Employees' Options

ITA
164(6.1)

Subsection 164(6.1) of the Act applies to certain employee stock options in respect of which a benefit has been included in a deceased

taxpayer's income by reason of subparagraph 7(1)(*e*) of the Act. This subsection applies where the employee stock option is exercised or disposed of by the deceased's legal representative in the first taxation year of the deceased's estate.

Subparagraph 164(6.1)(*a*)(iii) is amended by replacing the reference to the fraction "1/4" with a reference to the fraction "1/2". The change is consequential on the reduction in the capital gains inclusion rate from 3/4 to 1/2.

The amendment applies to deaths that occur after February 27, 2000 except that, for deaths that occur after February 27, 2000 and before October 18, 2000, the reference to the fraction "1/2" in subparagraph 164(6.1)(*a*)(iii) is to be read as a reference to "1/3". These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 85

Objections to Assessments

ITA
165(2.1)

Subsection 165(2.1) of the Act provides that the extension of time to object to an assessment referred to in subsection 165(1) applies only in respect of assessments and determinations made under Parts I, I.1 and I.2. The amendment to subsection 165(2.1) is strictly consequential on the repeal of the surtax imposed on individuals under Part I.1 of the Act (see commentary on that Part).

This amendment applies to the 2001 and subsequent taxation years.

Clause 86

Ecological Gifts

ITA
169(1.1)

New subsection 169(1.1) of the Act is added to provide a person with a right to appeal, within 90 days of the issue of a certificate by the Minister of the Environment under subsection 118.1(10.5), that Minister's redetermination or confirmation under subsection 118.1(10.4) of the fair market value of donated ecologically sensitive land.

This amendment applies to gifts made after February 27, 2000.

Clause 87

Ecological Gifts

ITA
171(1.1)

Section 171 of the Act provides the rules applicable to income tax appeals disposed of by the Tax Court of Canada. New subsection 171(1.1) adds rules applicable to appeals under new subsection 169(1.1) in respect of determinations of the fair market value of donated ecologically sensitive land.

This amendment applies to gifts made after February 27, 2000.

Clause 88

Individual Surtax

ITA
Part I.1

Part I.1 of the Act imposes a 5 per-cent surtax on that portion of an individual's Part I tax in excess of $12,500. This surtax is repealed,

effective for the 2001 and subsequent taxation years. For 2000, this surtax is equal to 5 per cent of the individual's Part I tax in excess of $15,500.

Clause 89

Tax In Respect of Certain Property Acquired by Trusts, etc.

ITA
Part XI

Part XI of the Act sets out the rules for the 1% per month penalty tax on deferred income plans and funds, master trusts and registered investments listed in section 205 in respect of their excess foreign property holdings.

Acquisition of Qualifying Security

ITA
206(3.1) and (3.2)

Section 206 of the Act imposes a tax on certain taxpayers, such as registered retirement savings plans, registered retirement income funds and registered pension plans, which invest more than a specified percentage of their assets in foreign property. Subparagraph 206(2)(*a*)(iii) provides relief from the imposition of this tax in respect of property that was not foreign property when it was acquired, but that subsequently becomes foreign property, by not treating such property as foreign property for up to 24 months. Subsection 206(3.1) extends the relief provided by that subparagraph where a security that is foreign property is issued to a taxpayer in exchange for another security in the course of a change in control of the corporation that issued the other security or a corporate merger or reorganization of capital. In these circumstances, the new security is likewise not treated as foreign property for up to 24 months if the other security was not foreign property.

Section 206 is amended so that the existing rule in subsection 206(3.1) is reflected in amended subsection 206(3.1) and new subsection 206(3.2).

New subsection 206(3.2) extends the relief provided by subparagraph 206(2)(*a*)(iii) to include the circumstances where a new security is issued to a taxpayer in exchange for another security in the course of a transaction or series of transactions in which all or substantially all of the issued and outstanding shares of a corporation (other than shares held by a particular person or related group) that issued the other security are acquired by the particular person or related group. This relief applies where the shares of a corporation acquired in the course of the transaction or series represent a minority interest in the corporation.

Subsection 206(3.2) also ensures that the relief provided by subparagraph 206(2)(*a*)(iii) is available to a taxpayer where a particular security of the taxpayer that became foreign property in circumstances to which that subparagraph applied is, during the period of up to 24 months applicable to the particular security, subject to an "eligible distribution" (as defined in new section 86.1). In these circumstances, the new security (in new section 86.1 referred to as a "spin-off share") acquired by the taxpayer is deemed under subsection 206(3.1) to have been last acquired by the taxpayer at the time the particular security was last acquired by the taxpayer and to have become foreign property at the time the particular security became foreign property. This is intended to ensure that the remaining portion of that period of up to 24 months available in respect of the particular security applies after the eligible distribution to both the particular security and the new security. For more detail on eligible distributions, see the commentary to new section 86.1.

These amendments apply to months that end after 1997.

Clause 90

Additional Tax

ITA
219

Section 219 of the Act imposes what is commonly known as the "branch tax" on non-resident corporations that carry on business in Canada.

Income Inclusion

ITA
219(1)(*d*)

Paragraph 219(1)(*d*) of the Act adds to the branch tax base the non-taxable portion of any net gain realized by a non-resident corporation on the disposition of taxable Canadian property used in a Canadian business. Paragraph 219(1)(*d*) is amended to delete the reference to "1/3 of". The amendment is consequential on the reduction of the inclusion rate for capital gains from 3/4 to 1/2.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxpayer's taxation year that ends after February 27, 2000 but before October 17, 2000, the reference to the expression "the amount" in that paragraph is to be read as a reference to "1/2 of the amount".

Clause 91

Compliance

ITA
231.5(2)

Subsection 231.5(2) of the Act makes it an offence to hinder, molest or interfere with an official who is performing certain administrative and enforcement functions. This provision does not apply in the context of an official who is performing a collection duty, or to attempts to hinder.

Subsection 231.5(2) is amended to apply to a person who interferes with, hinders, molests, or prevents (or attempts to prevent) an official from doing what the official is authorised to do by the Act. This amendment applies after the enacting legislation receives Royal Assent.

Clause 92

Provision of information

ITA
241

Section 241 of the Act prohibits the use or communication by an official of taxpayer information obtained under the Act unless specifically authorized by one of the exceptions found in that section.

Communication Where Proceedings have been Commenced, or to Investigate an Alleged Offence

ITA
241(3)

Subsection 241(3) of the Act authorizes the disclosure of taxpayer information in respect of

- criminal proceedings, where charges have been laid, and

- any legal proceeding relating to the administration or enforcement of certain statutes including the *Income Tax Act*.

Subsection 241(3) is amended to authorize the provision of taxpayer information to a police officer solely for the purpose of investigating an alleged offence, where:

- such information can reasonably be regarded as being relevant for the purpose of ascertaining the circumstances in which an offence under the *Criminal Code* may have been committed, or the identity of the person who may have committed an offence, in respect of an official (or a person related to that official),

- the official performed, or is performing, an act which the Act obliges or authorizes the official to perform, and

- the offence can reasonably be considered to be related to that act.

This amendment applies after the enacting legislation receives Royal Assent.

Where Information may be Disclosed

ITA
241(4)

Subsection 241(4) of the Act authorizes the communication of information to government officials, outside of the Canada Customs and Revenue Agency, for limited purposes. One of these purposes is the provision of taxpayer information solely for the purposes of section 24 of the *Statistics Act*.

Subsection 241(4) is amended to allow the disclosure of taxpayer information in respect of business activities carried on in a province to provincial statistical agencies. This exception applies only where such information is to be used by the provincial agency solely for research and analysis and that agency is authorized under the law of the province to collect the same or similar information on its own behalf in respect of such business activities. This amendment applies after the enacting legislation receives Royal Assent.

Clause 93

Transfer Pricing Capital Adjustment

ITA
247(1)

The "transfer pricing capital adjustment of a taxpayer" as defined in subsection 247(1) of the Act represents the transfer pricing adjustments made under subsection 247(2) that are in respect of capital property and eligible capital property of the taxpayer. The adjustment includes 3/4 of the adjustments with respect to non-depreciable capital property and eligible capital property and 100% of the adjustment with respect to depreciable capital property.

The definition is amended as a consequence of the reduction of the inclusion rate for capital gains from 3/4 to 1/2, with the result that only 1/2, rather than 3/4, of adjustments made under subsection 247(2) with respect to non-depreciable capital property will be included in the taxpayer‘s transfer pricing capital adjustment for a year.

The amendment applies to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000, the reference to "1/2" in the definition "transfer pricing capital adjustment" in subsection 247(1) is to be read as reference to the fraction in paragraph 38(*a*) of the Act that applies to the taxpayer for the year. These modifications are required in order to reflect the capital gains/losses rate for the year.

Clause 94

Definitions

ITA
248(1)

"foreign resource expense"

The definition "foreign resource expense" is added to subsection 248(1) of the Act, applicable for the purposes of the Act. The meaning of the expression is as defined in new subsection 66.21(1) of the Act. See the commentary on that subsection for information about this new definition. This amendment applies after 2000.

"foreign resource pool expenses"

The new definition "foreign resource pool expenses" is added to subsection 248(1) of the Act, applicable for the purposes of the Act. Foreign resource pool expenses comprise all foreign resource expenses in respect of all countries (as defined in the definition "foreign resource expense" in new subsection 66.21(1) of the Act) and foreign exploration and development expenses (as defined in subsection 66(15) of the Act). This amendment applies after 2000.

"foreign resource property"

The new definition "foreign resource property" in respect of a country is added, applicable for the purposes of the Act. The definition is structured in the same way as the amended definition "Canadian resource property" in subsection 66(15) of the Act, with necessary modifications to reflect the location of the property in a country outside Canada. This amendment applies after 2000.

"qualified donee"

The definition "qualified donee" is being included in subsection 248(1) of the Act so that the existing definition of the expression in subsection 149.1(1) applies for the purposes of the whole Act. This expression is used in new subsections 118.1(5.1), (5.2) and (5.3). The definition "qualified donee" in subsection 149.1(1) refers to specified entities (including registered charities) the gifts to which can give rise to the charitable donations tax credit.

This amendment applies after 1998.

Clause 95

Disposition of Partnership Property

S.C. 1991, C.49
236(1)

Income Tax Act
98(3) and (5)

Subsection 98(3) of the *Income Tax Act* is an elective provision permitting property of a Canadian partnership which has ceased to exist to be distributed to its members, for proceeds to the partnership and at a cost to the members, equal to the cost amount of the property to the partnership, provided certain conditions are met. Where those conditions are met, this provision allows a special increase or "bump-up" in the tax value of the distributed partnership property where the adjusted cost base of a member's partnership interest exceeds the amount of any money and the cost amount to the partnership of the property which the member has received upon the dissolution.

Paragraph 98(3)(*d*), which allowed one-half of this excess to be allocated to property other than non-depreciable capital property up to the fair market value of the property, was repealed, applicable in respect of certain events that occur after December 4, 1985. That paragraph, which continues to apply in respect of certain "grandfathered" partnership property, was amended in the past as the result of changes to the inclusion rate for capital gains.

Subsection 98(5) of the Act contains rules which provide a tax-deferred transfer or "rollover" of a Canadian partnership's property where the partnership has ceased to exist and the transfer is to one member of the partnership who continues to carry on the business of the partnership as a sole proprietor.

Where the adjusted cost base of the member's partnership interest, including the interests acquired from other members, exceeds the amount of any money and the cost amount to the partnership of the property received by the proprietor upon the dissolution, the member may designate this excess to be added to the cost base of one of more particular properties.

Paragraph 98(5)(*d*), which allowed one-half of this excess to be allocated to property other than non-depreciable capital property, was repealed, applicable in respect of certain events that occurred after December 4, 1985. That paragraph, which continues to apply to certain "grandfathered" partnership property, was amended in the past as results of the changes to the inclusion rate for capital gains.

The grandfathering provisions in paragraphs 98(3)(*d*) and (5)(*d*) are amended to replace a taxpayer's 3/4 capital gains inclusion rate used in the paragraph in a taxation year or fiscal period to the fraction required to be used by the taxpayer in the year or fiscal period under paragraph 38(*a*) or (*b*) of the Act.

These amendments are deemed to have come into force on December 19, 1986.

Amendments to the Canada Pension Plan

Clause 96

Amount of Contributory Salary and Wages

CPP
12(1)

Subsection 12(1) of the *Canada Pension Plan* (CPP) defines a person's "contributory salary and wages" for a year, which is the basis on which contributions are to be made under the plan. The amount of a person's contributory salary and wages for a year is the person's

income for the year from employment, computed in accordance with the *Income Tax Act* (ITA), plus any deductions for the year made in computing that income (otherwise than under paragraph 8(1)(*c*) of the ITA).

Subsection 12(1) of the CPP is amended to provide that, in computing a person's income from employment under the ITA, subsection 7(8) of the ITA is to be disregarded. Under that subsection 7(8), the benefit realized when a person acquires a qualifying security under an employee option agreement is not included in computing the person's employment income until the year in which the person disposes of the security. However, if subsection 7(8) of the ITA were disregarded, the benefit would be included in computing the person's employment income for the year in which the security is acquired.

The effect of the amendment to subsection 12(1) of the CPP is to provide that, even though an employment benefit to which subsection 7(8) of the ITA applies is not taxed until the person disposes of the related security, the benefit is treated for CPP purposes as though it were included in the person's employment income in the year in which the security is acquired. Accordingly, the benefit is relevant for determining CPP contributions in the year of acquisition, rather than in the year of disposition. This ensures that employers – who have no reporting obligations under the ITA in respect of such amounts beyond the year in which the security is acquired – are able to comply with their remittance obligations under the CPP. (For further details, see the commentary on new subsections 7(8) to (16) of the ITA, and the commentary in Appendix A on proposed subsection 200(5) of the *Income Tax Regulations*.)

This amendment applies to the 2000 and subsequent taxation years. New subsection 7(8) of the ITA applies to qualifying securities acquired after February 27, 2000.

Clause 97

Compliance

Excise Tax Act
101

New section 101 of the *Excise Tax Act* makes it an offence to hinder, molest or interfere with, or attempt to hinder, molest or interfere with, an official who is performing any act that the official is authorized to perform under Parts I to VII of the Act. This section also makes it an offence to prevent or attempt to prevent an official from performing such an act. Every person who is guilty of an offence under this provision is liable, on summary conviction, to a fine of between $1,000 and $25,000 or to such a fine and a term of imprisonment of up to one year. This section is consistent with the offence provisions under section 238 of the *Income Tax Act* for failure to comply with subsection 231.5(2) of that Act, and under section 326 of Part IX of the *Excise Tax Act* for failure to comply with subsection 291(2) of that Act, as amended.

New section 101 comes into force on Royal Assent.

Clause 98

Compliance

Excise Tax Act
291(2)

Subsection 291(2) of the *Excise Tax Act* prohibits a person from hindering, molesting or interfering with an official performing certain administrative and enforcement functions under Part IX of the Act. The subsection also prohibits a person from preventing or attempting to prevent an official from performing those functions. The existing provision does not apply in the context of an official who is performing a collection duty, or to attempts to hinder, molest or interfere with an official.

Subsection 291(2) is amended to apply in respect of any act that the official is authorized under Part IX of the Act to perform. The

provision is also amended to prohibit a person from attempting to hinder, molest or interfere with an official who is performing any such act.

Subsection 291(2) is further amended to place a positive obligation on a person to do everything the person is required to do by or pursuant to the audit and examination provisions of Part IX of the Act (i.e., sections 288 to 292). This amendment is made as a consequence of certain wording changes to subsection 326(1) of the *Excise Tax Act*, which makes it an offence to, among other things, not comply with these audit and examination provisions (see the commentary on subsection 326(1) of the *Excise Tax Act*). Amended subsection 291(2) parallels the wording of the corresponding provision of the *Income Tax Act*, subsection 231.5(2), as amended.

This amendment comes into force on Royal Assent.

Clause 99

Provision of Information

Excise Tax Act
295(4)

Section 295 of the *Excise Tax Act* prohibits the use or communication of information obtained under Part IX of the Act by an official unless specifically authorized by one of the exceptions found in that section. Subsection 295(4) of the Act authorizes the disclosure of such information in respect of criminal proceedings that have already commenced or any legal proceeding relating to the administration and enforcement of certain statutes including the *Excise Tax Act*.

Subsection 295(4) is amended to also authorize the provision of confidential information to a police officer solely for the purpose of investigating an alleged offence against an official, or a person related to the official, who performed or is performing an act that Part IX of the *Excise Tax Act* obliges or authorizes the official to perform. This provision would apply only if the alleged offence can reasonably be considered to be related to such an act.

This amendment comes into force on Royal Assent.

Clause 100

Offences

Excise Tax Act
326(1)

Existing subsection 326(1) of the *Excise Tax Act* makes it an offence to fail to file or make a return as and when required by or under Part IX of the *Excise Tax Act*, or to fail to comply with an obligation under certain provisions relating to keeping books and records and to inspections and requests for information by the Minister of National Revenue or an official. A person who is found guilty of an offence under this provision is liable on summary conviction to a fine of between $1,000 and $25,000 or to such a fine and a term of imprisonment of up to one year.

This subsection is amended so that it is also an offence under this provision to fail to comply with the prohibition under subsection 291(2) of the Act dealing with hindering or interfering with an official. Specifically, amended subsection 291(2) prohibits a person from hindering, molesting or interfering with an official performing, or preventing an official from performing, any function that the official is authorized to perform under Part IX of the *Excise Tax Act*. Subsection 291(2) also prohibits a person from attempting to hinder, molest or interfere with an official. The extension of the penalty under subsection 326(1) to this particular offence parallels the corresponding penalty under the *Income Tax Act*, subsection 238(1).

In addition, subsection 326(1) is amended to coincide with amended subsection 291(2), which imposes the positive obligation on a person to do everything that the person is required to do under the audit and examination provisions of Part IX of the Act (i.e., sections 288 to 292). As a consequence, it is no longer necessary for subsection 326(1) to refer directly to a failure to comply with the obligations under sections 288, 289 and 292. It is sufficient to refer to a failure to comply with subsection 291(2).

These amendments come into force on Royal Assent.

APPENDIX A

DRAFT *INCOME TAX REGULATION* AND EXPLANATORY NOTE

Information Returns

1. Section 200 of the *Income Tax Regulations* is amended by adding the following after subsection (4):

(5) Where a particular qualifying person (within the meaning assigned by subsection 7(7) of the Act) has agreed to sell or issue a security (within the meaning assigned by subsection 7(7) of the Act) of the particular qualifying person (or of a qualifying person with which it does not deal at arm's length) to a taxpayer who is an employee of the particular qualifying person (or of a qualifying person with which the particular qualifying person does not deal at arm's length) and the taxpayer has acquired the security under the agreement in circumstances to which subsection 7(8) of the Act applied, each of the particular qualifying person, the qualifying person of which the security is acquired and the qualifying person which is the taxpayer's employer shall, for the particular taxation year in which the security is acquired, make an information return in prescribed form in respect of the benefit from employment that the taxpayer would be deemed to have received in the particular taxation year in respect of the acquisition of the security if the Act were read without reference to subsection 7(8) and, for this purpose, an information return made by one of the qualifying persons in respect of the taxpayer's acquisition of the security is deemed to have been made by each of the qualifying persons.

2. Section 1 applies to the 2000 and subsequent taxation years.

Explanatory Note

ITR
200(5)

New subsection 200(5) of the *Income Tax Regulations* contains special reporting requirements relating to securities acquired under employee option agreements in circumstances to which new subsection 7(8) of the *Income Tax Act* applies. Under that subsection 7(8), taxation of the employment benefit arising from the acquisition of an employee option security after February 27, 2000 is deferred until the employee disposes of the security, provided certain conditions are met. Although taxation is deferred, new subsection 200(5) of the Regulations requires that an information return reporting the deferred amount be filed with the Minister of National Revenue in the year in which the employee acquires the security.

Under subsection 200(5), each of the following parties is jointly liable for filing the information return: the employer, the entity that granted the option under which the security is acquired and the entity whose security is acquired under the option. However, each of the parties is considered to have satisfied the filing requirement if one of the parties satisfies the requirement. This allows the parties involved in the agreement to determine who should be responsible for reporting the deferred employment benefit.

Subsection 200(5) requires that the information return be made in prescribed form as determined by the Minister of National Revenue. The prescribed form will be the employee's T4 slip for the year in which the security is acquired, and the deferred amount will be reported as a separate item on that slip.

It should be noted that this requirement is the only reporting requirement relating to the deferred employment benefit that is imposed on the parties involved in the option agreement. The onus is on the employee to include the deferred amount in computing employment income when filing the tax return for the year in which the security is disposed of.

New subsection 200(5) of the Regulations applies to the 2000 and subsequent taxation years.

APPENDIX B

DRAFT *INCOME TAX REGULATION* AND EXPLANATORY NOTES

Capital Gains Deferral (Eligible Small Business Investments)

1. (1) The portion of subsection 6204(1) of the *Income Tax Regulations* before paragraph (*a*) is replaced by the following:

(1) For the purposes of paragraph 110(1)(d) and section 44.1 of the Act, a share is a prescribed share of the capital stock of a corporation at the time of its sale or issue, as the case may be, where, at that time,

(2) Subsection (1) applies in respect of dispositions that occur after February 27, 2000.

Explanatory Note

ITR
6204(1)

Subsection 6204(1) of the *Income Tax Regulations* prescribes a common share for the purposes of paragraph 110(1)(*d*) of the *Income Tax Act*. The subsection is amended to have it also apply for the purposes of section 44.1 of the Act.